

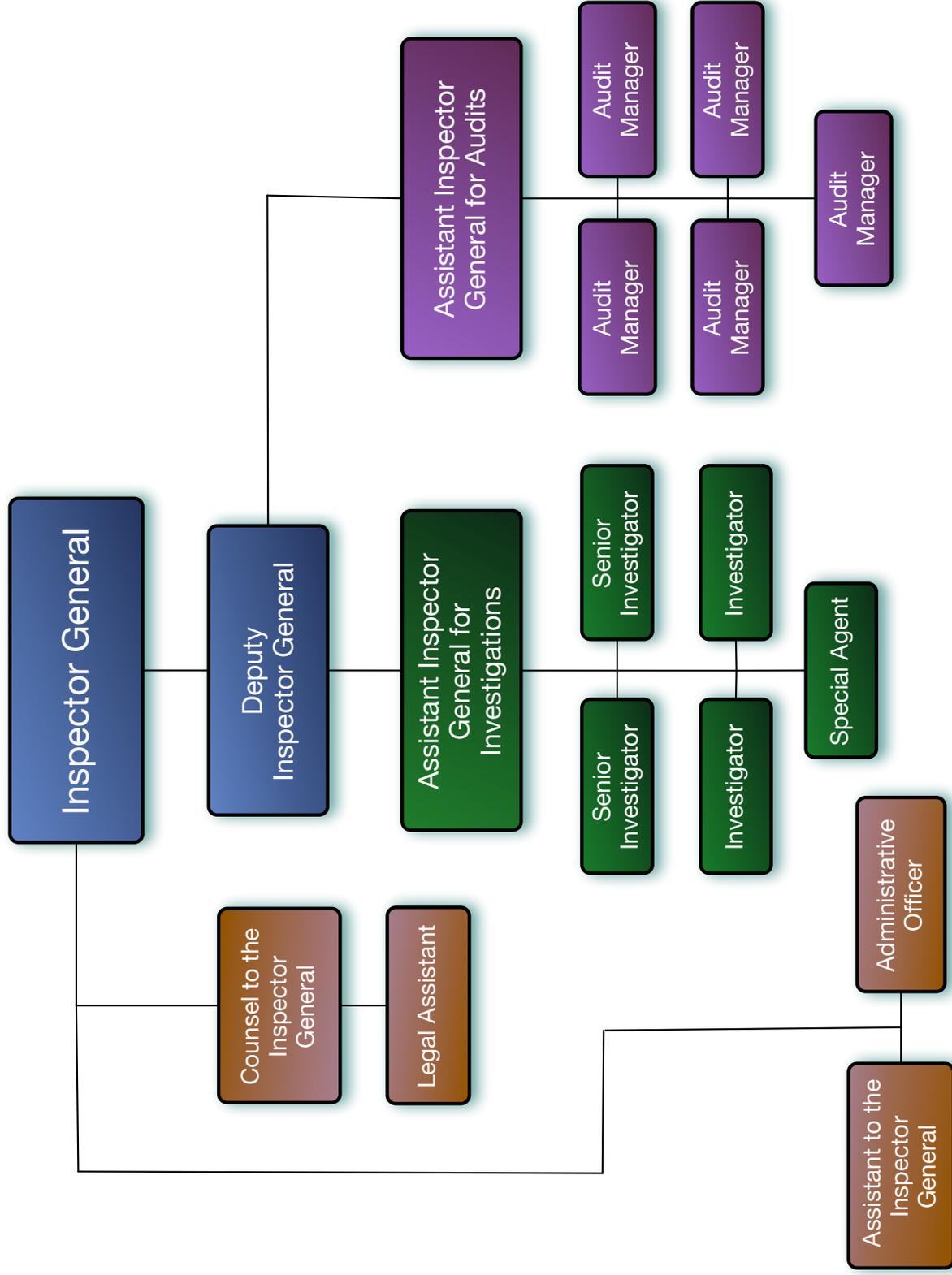


U.S. SECURITIES AND EXCHANGE COMMISSION
OFFICE OF INSPECTOR GENERAL

SEMIANNUAL REPORT TO CONGRESS
OCTOBER 1, 2008 - MARCH 31, 2009

Organizational Chart

Office of Inspector General



October 1, 2008 - March 31, 2009



**U.S. Securities
and Exchange
Commission**

OFFICE OF INSPECTOR GENERAL SEMIANNUAL REPORT TO CONGRESS

MISSION

The mission of the Office of Inspector General (OIG) is to promote the integrity, efficiency, and effectiveness of the critical programs and operations of the United States Securities and Exchange Commission (SEC). This mission is best achieved by having an effective, vigorous and independent office of seasoned and talented professionals who perform the following functions:

- Conducting independent and objective audits, evaluations, investigations, and other reviews of SEC programs and operations;
- Preventing and detecting fraud, waste, abuse, and mismanagement in SEC programs and operations;
- Identifying vulnerabilities in SEC systems and operations and recommending constructive solutions;
- Offering expert assistance to improve SEC programs and operations;
- Communicating timely and useful information that facilitates management decision-making and the achievement of measurable gains; and
- Keeping the Commission and the Congress fully and currently informed of significant issues and developments.



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MESSAGE FROM THE **INSPECTOR GENERAL**

I am pleased to present the Securities and Exchange Commission (SEC) Office of Inspector General's (OIG) Semiannual Report to Congress for the period from October 1, 2008 through March 31, 2009. This report is required by the Inspector General Act of 1978, as amended, and covers the work performed by the OIG during the period indicated.

The reporting period was a very eventful and productive one for the OIG. On December 16, 2008, former SEC Chairman Christopher Cox asked me to undertake an investigation into complaints made to the Commission regarding Bernard L. Madoff, who was arrested on December 11, 2008, for running a Ponzi scheme. Former Chairman Cox asked that the OIG investigate the reasons that allegations made to the SEC about Madoff were found to be not credible. Former Chairman Cox also requested that the OIG investigate all staff contact and relationships with the Madoff family and firm and any impact such relationships had on staff decisions regarding the firm. Early on December 17, 2008, we opened an official investigation into the Madoff matter and, since that time, have made substantial progress in the investigation.

On January 5, 2009, I testified before the United States House of Representatives Committee on Financial Services about the Madoff investigation being conducted by my Office. In that testimony, I indicated that the OIG would investigate several specific issues, including how the SEC handled complaints it received regarding Madoff; whether examinations of the Madoff firm were affected by conflicts of interest between SEC officials or staff and members of the Madoff family; the extent to which Madoff's reputation, status and professional relationships with SEC officials may have affected staff decisions regarding investigations and examinations of his firm; and whether there were "red flags" signaling a Ponzi scheme that were overlooked in examinations of the Madoff firm.

I also testified at a second House of Representatives hearing on March 25, 2009, before the Subcommittee on Government Management, Organization and Procurement, Committee on Oversight and Government Reform, entitled: "The Roles and Responsibilities of Inspectors General within Financial Regulatory Agencies." In this testimony, I discussed the efforts undertaken by the SEC OIG to respond to the increasing number of strategic challenges facing the Federal financial regulatory agencies in light of the current economic crisis. I provided several suggestions to the Subcommittee for legislative changes that would assist Inspectors General in performing their critical oversight duties. I further updated the Subcommittee on the status of current SEC OIG investigative and audit matters, including the Madoff investigation.

Although the Madoff investigation has consumed a great deal of the OIG's resources, we have continued our other important audit and investigatory work during this reporting period. In February 2009, we concluded a comprehensive audit of the Division of Enforcement's (Enforcement) process whereby \$177,605,521 of disgorgements against defendants or respondents in

Enforcement actions were waived for purported inability to pay over approximately a three-year period. The audit found deficiencies in the disgorgement waiver process, including situations where full waivers were granted even though the defendants or respondents demonstrated some ability to pay, defendants' or respondents' assets were not accurately reported to Enforcement, and adequate supporting documentation was not obtained. We made eight recommendations designed to improve the process.

In March 2009, the OIG completed an audit of Enforcement's policies, procedures and practices for processing complaints, including those about the practice of naked short selling. Our audit found that Enforcement has brought very few actions based on conduct involving abusive or manipulative naked short selling and that, in fact, only a small amount of naked short selling complaints were even forwarded after the initial complaint intake for additional investigation. We further found that Enforcement's existing complaint receipt and processing procedures hinder its ability to respond effectively to naked short selling complaints and referrals and identified 11 recommendations to strengthen Enforcement's controls over complaints, including those pertaining to naked short selling.

The OIG conducted several additional audits and reviews during the reporting period. These included analyses of the SEC's Division of Corporation Finance's process for assessing whether issuers of securities appropriately use Regulation D exemptions from the registration requirements of the Securities Act of 1933; the efficacy and cost-effectiveness of an agency restacking project, which changed the configuration of the layout of staff offices; the effectiveness of the agency's controls over sensitive payments, which consist of a wide range of executive functions, including compensation, travel, official entertainment funds, unvouchered expenditures, consulting services, speaking honoraria and gifts, and executive perquisites for senior-level officials; the SEC's public transportation benefit program; and Information Technology issues reviewed pursuant to the Federal Information Security Management Act of 2002.

Our investigative unit also completed numerous investigations during the reporting period in response to allegations of violations of statutes, rules and regulations, and other misconduct by SEC staff and contractors. In March 2009, we completed an investigation of several Enforcement attorneys' frequent trading activities and found that, in several instances, two Enforcement attorneys sold or purchased stock of companies shortly after they potentially learned of the existence of Enforcement investigations of these companies, and committed violations of various aspects of the SEC's rules on reporting of stock transactions. The investigation further revealed that the SEC has essentially no compliance system in place to ensure that SEC employees, with tremendous amounts of non-public information at their disposal, do not engage in insider trading. We referred the the potential insider trading on the part of the two Enforcement attorneys to the United States Attorney's Office for the District of Columbia's Fraud and Public Corruption Section, which, together with the Federal Bureau of Investigation, is conducting an investigation of possible criminal and civil violations. The OIG is coordinating with the United States Attorney's Office in connection with the ongoing

investigation. We also provided management with 11 specific recommendations to ensure adequate monitoring of employees' stock transactions in the future.

In addition, we issued investigative reports on numerous other matters, including findings of violations of the District of Columbia Metropolitan Police Department regulations pertaining to Security Officers regulations on the part of a security guard manager working at the SEC as a contractor, chronic leave abuse on the part of a mid-level SEC employee, and a lack of impartiality by a senior SEC official.

Further, in order to strengthen the oversight of the Federal financial regulatory structure as a whole, the OIG worked in tandem with other Federal financial regulatory Inspectors General to provide coordinated oversight during this reporting period. For example, in January 2009, I began serving on the Troubled Asset Relief Program (TARP) Inspector General Council, along with the Special Inspector General for the TARP, and Inspectors General from several financial regulatory agencies, as well as the Government Accountability Office. The TARP Inspector General Council meets periodically to discuss coordination of TARP-related activities and oversight efforts. I also meet separately every month with additional Federal financial regulatory Inspectors General to discuss coordinated oversight efforts among the financial regulatory Inspector General community.

The accomplishments of my Office during the reporting period have been enhanced by the support of the former and current SEC Chairmen, as well as the SEC's management team and employees. I look forward to continuing this productive and professional working relationship as we continue to help the SEC meet its important challenges.



H. David Kotz
Inspector General



SEMIANNUAL REPORT TO CONGRESS

MANAGEMENT AND ADMINISTRATION

AGENCY OVERVIEW

The United States Securities and Exchange Commission aims to be the standard against which Federal agencies are measured. The SEC's vision is to strengthen the integrity and soundness of the United States securities markets for the benefit of investors and other market participants, and to conduct its work in a manner that is as sophisticated, flexible, and dynamic as the securities markets it regulates.

The SEC's mission is to protect investors, facilitate capital formation and maintain fair, orderly, and efficient markets. To achieve its mission, the SEC enforces compliance with the Federal securities laws, promotes healthy capital markets through an effective and flexible regulatory environment, fosters informed investment decision making, and maximizes the use of human capital and technological resources.

SEC staff monitor and regulate a securities industry that includes approximately 37,000 investment company portfolios (including mutual funds, closed-end funds, unit investment

trusts, exchange-traded funds, interval funds, and variable insurance products), over 11,000 Federally registered advisors, approximately 5,600 broker-dealers, about 600 transfer agents, 11 securities exchanges, the Financial Industry Regulatory Authority, four securities futures products exchanges, seven clearing agencies, ten credit rating agencies, the Public Company Accounting Oversight Board, and the Municipal Securities Rulemaking Board. The SEC also selectively reviews the disclosures of about 12,000 public companies under the Securities Act of 1933 and the Securities Exchange Act of 1934.

In order to accomplish its mission most effectively and efficiently, the SEC is organized into four main divisions (Corporation Finance, Enforcement, Investment Management, and Trading and Markets), and also has 18 functional offices. The Commission's headquarters is located in Washington, D.C., and there are 11 regional offices located throughout the country. In Fiscal Year (FY) 2008, the SEC had 3,511 full-time equivalents (FTE) consisting of 3,442 permanent and 99 temporary FTE.

OIG STAFFING

During the reporting period, the OIG hired two new criminal investigators, including a new Assistant Inspector General for Investigations (AIGI). In March 2009, J. David Fielder joined the OIG as the new AIGI. Mr. Fielder supervises the OIG's Office of Investigations, which responds to and investigates alleged violations of statutes, rules and regulations, and other misconduct by SEC staff and contractors.

Prior to joining the OIG, Mr. Fielder was a partner at the law firm of Haynes and Boone LLP where he represented individuals and companies involved in SEC investigations and examinations. Mr. Fielder joined Haynes and Boone after working at the SEC for ten years as a Branch Chief in the Division of Enforcement, an Advisor to the Director of the Division of Investment Management, and a Counsel to the Chairman.

Mr. Fielder is a 1987 graduate of Washington University in St. Louis, where he received his Bachelor of Arts degree magna cum laude and was a member of Phi Beta Kappa. Mr. Fielder also received a Master of Science degree from the University of Pennsylvania in 1989 and a Juris Doctor degree from the University of Michigan in 1992.

In February 2009, David Witherspoon joined the OIG as a Senior Investigator. Prior to that time, Mr. Witherspoon was a Senior Counsel in the SEC's Division of Enforcement, where he investigated complex financial fraud cases for nearly nine years. Before joining the SEC in 2000, Mr. Witherspoon worked as an associate at the law firm of McKenna & Cuneo, LLP (now McKenna Long & Aldridge, LLP) for nearly six years, specializing in commercial civil litigation.

Mr. Witherspoon is a 1990 graduate of Georgetown University, where he received his Bachelor of Arts degree magna cum laude in Government. Mr. Witherspoon received his Juris Doctor degree from Harvard Law School in 1994.

During this reporting period, Mary Beth Sullivan, Counsel to the Inspector General, was elected Chair of the Council of Counsels to the Inspector General (CCIG) for 2009. The CCIG is an informal group of Federal Inspector General attorneys who meet periodically, and otherwise communicate, to share information and discuss issues of common interest to the Federal IG community. As CCIG Chair, Ms. Sullivan leads the group's monthly meetings and coordinates with the two CCIG Vice-Chairs and members, as well as with other components of the Inspector General community.

NEW OIG WEBSITE

During this semiannual reporting period, the OIG completed development of its new website. On or about December 17, 2008, the new website, www.sec-oig.gov, was launched, featuring streamlined navigational tools for access to general information about the OIG, its mission and staff, as well as more specific information concerning the OIG's two central components, the Office of Audits and Office of Investigations. The website provides online visitors with direct access to expanded content, such as audit and evaluation reports, several years of OIG Semiannual Reports to Congress, testimony the Inspector General has given before Congress, and biographies of OIG senior staff members.

Another new feature of the website is the option of subscribing to an RSS feed that

provides updates to subscribers of newly-issued
OIG reports. Finally, the website provides
visitors with information concerning how to

access the OIG's telephone and web-based
Hotline to make confidential complaints to the
OIG.



SEMIANNUAL REPORT TO CONGRESS

CONGRESSIONAL TESTIMONY, BRIEFINGS AND REQUESTS

During the reporting period, the OIG had extensive communications with Congressional officials through testimony, meetings, and written and telephonic communications.

On January 5, 2009, the Inspector General (IG) testified before the United States House of Representatives Committee on Financial Services on the subject of "Assessing the Madoff Ponzi Scheme." In that testimony, the IG described the OIG's operations, and discussed several significant audit and investigative reports that had been issued. The IG also discussed in great detail the OIG's planned approach to investigating why the SEC did not discover that Bernard L. Madoff (Madoff) was running a Ponzi scheme prior to his arrest on December 11, 2008. The IG specified the particular issues that would be investigated, including how the SEC handled complaints it received regarding Madoff; whether examinations of Madoff's firm were affected by conflicts of

interest between SEC officials or staff and members of the Madoff family; the extent to which Madoff's reputation, status and professional relationships with SEC officials may have affected staff decisions regarding investigations and examinations of his firm; and whether there were "red flags" signaling a Ponzi scheme that were overlooked in examinations of Madoff's firm.

The IG further explained during his testimony that he understood the importance of conducting the OIG's investigative efforts relating to Madoff expeditiously and informed the Committee that he had mobilized additional resources to ensure the OIG made every possible effort to conclude its investigation in a timely manner. The IG also assured the Committee that the OIG's investigation and related reviews would be independent and as hard-hitting as necessary and that the OIG would conduct its work in a comprehensive and thorough manner. The

IG further made clear to the Committee that if it finds that criticism of the SEC is warranted and supported by the facts, the OIG will not hesitate to report the facts and conclusions as it finds them. The full text of the IG's written testimony is contained in Appendix A to this Semiannual Report. Information about the entire hearing is available at http://www.house.gov/apps/list/hearing/financialsvcs_dem/hr010509.shtml.

The IG also testified at a second House of Representatives hearing on March 25, 2009, before the Subcommittee on Government Management, Organization and Procurement, Committee on Oversight and Government Reform, entitled: "The Roles and Responsibilities of Inspectors General within Financial Regulatory Agencies." In this testimony, the IG discussed the efforts undertaken by the OIG to respond to the increasing number of strategic challenges facing Federal financial regulatory agencies in light of the current economic crisis. He also provided suggestions to the Subcommittee for legislative changes that would assist Inspectors General in performing their oversight duties. The full text of the IG's written testimony before this hearing is contained in Appendix B to this Semiannual Report.

During the reporting period, the IG also met with staff of several Congressional Committees and Members of Congress to provide information about ongoing OIG activities and to respond to Congressional inquiries. For example, in October 2008, the IG had several conversations and a meeting with the Deputy Chief Counsel and other staff members of the House of Representatives Committee on Oversight and Government Reform to assist in their preparation for a hearing on the collapse of investment banks. Also in October 2008, the IG met with staff members of the Senate Committee on Finance to discuss the request of Ranking Member Senator Charles Grassley (R-Iowa) for information and documents from the SEC concerning a matter Senator Grassley had asked the OIG to investigate.

The IG had numerous other conversations with Congressional staff members, as well as meetings in January 2009 with Representative Jo Ann Emerson (R-Missouri) and in March 2009 with Senator Grassley's staff about the OIG's pending Madoff investigation. The OIG also replied to inquiries from Members of Congress about matters of interest to individual constituents.



SEMIANNUAL REPORT TO CONGRESS

ADVICE AND ASSISTANCE PROVIDED TO THE AGENCY AND THE GOVERNMENT ACCOUNTABILITY OFFICE

During this semiannual reporting period, the OIG provided advice and assistance to management on several issues that were brought to our attention. This advice was conveyed through written communications, as well as discussions with agency officials. In addition to recommending improvements in existing procedures, we provided numerous comments on proposed policy and rule changes that were being implemented by management, some in response to previous OIG recommendations. The OIG also worked with and provided significant assistance to the Government Accountability Office (GAO) in connection with its audit of the SEC's FY 2008 financial statements.

Ethics Guidance to Staff on Impartiality in Performance of Official Duties

The OIG reviewed a draft memorandum prepared by the SEC Ethics Office to provide guidance to SEC staff as a result of inquiries

received concerning the propriety of staff participating in matters in which former SEC colleagues are representing person with interests before the agency. After reviewing the draft memorandum, the OIG suggested a few additions to the memorandum. Specifically the OIG recommended that the guidance make clear that in the case of matters involving former associates or individuals with whom SEC staff had a personal friendship, these individuals should be treated no differently than a stranger would be treated in the performance of official duties. The OIG also suggested that the guidance clarify that under no circumstances should an SEC staff member give preferential treatment to any individual, including a former associate or colleague, and provide an example of what would constitute prohibited preferential treatment. The OIG's recommendations were incorporated into the guidance issued by the SEC Ethics Counsel to all SEC employees on December 23, 2008.

Notification to the OIG of Decisions on Disciplinary Action and Settlement Agreements

In the course of working with Department of Justice (DOJ) attorneys on a matter the OIG had referred for criminal prosecution in the previous reporting period, the OIG learned that the agency had entered into a settlement agreement in connection with the subject's appeal of her removal from the Federal service based upon the OIG's report of investigation. The OIG had not been informed or kept apprised of the appeal, the ensuing settlement discussions or the settlement itself, despite the fact that the appeal was filed more than three months before the settlement.

Moreover, the OIG learned that during the settlement discussions, management had actually considered the possibility of reinstating the subject, which could have seriously compromised the ongoing criminal prosecution. Notwithstanding the fact the subject was not reinstated, there remained a concern as to the negative impact the settlement agreement could have on DOJ's ability to prosecute this individual successfully. In fact, DOJ counsel expressed grave concern with SEC management's decision to settle with the subject and its failure to notify the OIG of the settlement.

In view of the foregoing concerns, the OIG issued a memorandum on January 23, 2009 (Investigative Memorandum No. 464), making recommendations designed to ensure that the OIG is appropriately kept apprised of management decisions on disciplinary actions and settlement agreements. Specifically, the OIG recommended that: (1) the Office of General Counsel (OGC) or the Office of Human Resources (OHR) provide the OIG

with at least three business days written notice prior to making a final decision in response to recommendations for disciplinary action contained in OIG reports of investigation; and (2) the OGC provide the OIG with at least five business days written notice prior to the SEC executing a settlement agreement with a subject who appealed a disciplinary action stemming from a recommendation made in an OIG report of investigation.

Management had taken no action on these recommendations as of the end of the reporting period. However, a new SEC Chairman, Mary L. Schapiro, was sworn in on January 27, 2009. We are hopeful that actions to address these issues will be taken promptly.

Revised Regulation on Use of SEC Office Equipment

As a result of prior OIG investigations into several employees' misuse of SEC resources and official time to view pornography, the OIG had recommended that the Office of the Executive Director (OED), in consultation with the OGC and the Office of Information Technology (OIT), update, consolidate and clarify the agency's Internet usage policies, including SEC Regulation (SECR) 24-4.3, "Use of SEC Office Equipment," which had not been updated since March 2002. In October 2008, the OIG reviewed a revised draft of SECR 24-4.3 and provided written comments on the draft to the OHR and the OED. The OIG recommended, among other things, that the language in the draft policy be clarified to specify what uses of SEC resources were prohibited because they discredited the agency. The OIG also recommended that the section of the policy concerning inappropriate

personal uses of SEC office equipment strongly warn employees that they are strictly prohibited from engaging in certain activities, similar to language found in the Office of Information Technology's Rules of the Road that govern the use of agency computing and network facilities. As of the end of the reporting period, management had not yet issued the revised policy.

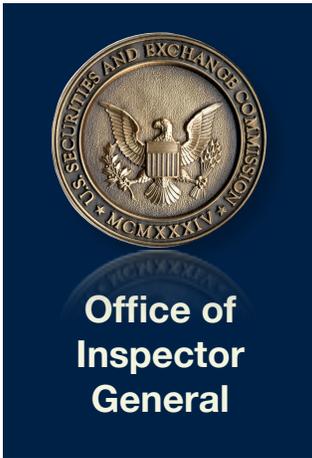
Office of Information Technology Policies and Procedures

During the reporting period, the OIG reviewed and provided written comments to management on several drafts of various OIT policies, procedures, instructions and directives. The draft documents on which the OIG provided comments included: (1) an Implementing Instruction on the Use and Reduction of Social Security Numbers in SEC Systems and Programs; (2) an Implementing Instruction on the Rules of Conduct for Safeguarding Personally Identifiable Information; (3) an SEC Regulation on the SEC's Privacy Program; (4) an Operating Directive on Privacy Incident Management; (5) an Implementing Instruction on Privacy Incident Response Capability; (6) an SEC Regulation on the SEC's Paperwork Reduction Program; (7) an Operating Directive on Paperwork Reduction Program Requirements; (8) the SEC Rules of the Road and related Compliance Agreement;

(9) an Interim Policy Memorandum on SEC Information Technology Asset Management Accountability Controls and Responsibilities; and (10) an Implementing Instruction on Sensitive Information Encryption within the SEC. OIT has incorporated many of the OIG's comments into its revisions of these policy documents.

Assistance Provided to the GAO in Connection with the Audit of the SEC's Fiscal Year 2008 Financial Statements

During the period, the OIG worked in coordination with and provided significant assistance to the GAO in connection with its audit of the agency's FY 2008 financial statements. As described in detail in the Audits and Evaluations Conducted section of this Report, the OIG conducted a limited scope audit of sensitive payments to senior SEC officials in support of the GAO's FY 2008 financial statement audit. In addition, OIG audit staff worked closely with the GAO and the SEC's Office of Financial Management (OFM) in connection with the SEC's special purpose financial statements (which are prepared in accordance with standards established by the Department of Treasury's (Treasury) Financial Management Services Branch). As a result of the OIG's work, we provided Treasury with an unqualified opinion on the SEC's special purpose financial statements.



SEMIANNUAL REPORT TO CONGRESS

AUDITS AND EVALUATIONS

OVERVIEW

The OIG's Office of Audits focuses its efforts on conducting and supervising independent audits and evaluations of the SEC's programs and operations. The Office of Audits also hires independent contractors and subject matter experts to conduct work on its behalf. Specifically, we review the SEC's programs and operations to determine whether:

- There is compliance with governing laws, regulations and policies;
- Resources are safeguarded and appropriately managed;
- Funds are expended properly;
- Desired program results are achieved; and
- Information provided by the agency to the public and others is reliable.

Audits

Audits examine operations and financial transactions to ensure that proper management practices are being followed and resources are being adequately protected in accordance with laws and regulations. Audits are systematic, independent and documented processes for obtaining evidence.

In general, audits are conducted when firm criteria or data exist, sample data is measurable, and testing internal controls is an integral component of our objectives. The OIG's audits focus on SEC programs and operations related to areas such as the oversight and examination of regulated entities, the protection of investor interests, and the evaluation of administrative activities. The Office of Audits conducts audits in accordance with OIG policy, generally accepted government auditing standards (Yellow Book) issued by the Comptroller General of the United States, as well as guidance issued by the Council of the Inspectors General on Integrity and Efficiency (CIGIE).

Evaluations

The Office of Audits also conducts evaluations when non-audit services or consulting services are rendered to the agency, or when a project's objectives are based on specialty and highly technical areas. Evaluations are reviews that typically cover broad areas and are designed to provide SEC management with timely and useful information associated with current or anticipated problems. Evaluations are conducted in accordance with OIG policy, the non-audit service standards of the Yellow Book, or guidance issued by the CIGIE.

Audit Follow-up and Resolution

In addition to performing audits and evaluations, the Office of Audits actively monitors the internal system that tracks management's implementation of the corrective actions that are recommended in OIG reports, and performs audit resolution and follow-up activities for these recommendations. In order to ensure that all recommendations for improvement in agency programs and operations are appropriately and timely resolved and implemented, the OIG, in coordination with agency management, drafted a detailed regulation prescribing the policies and procedures to be followed by the SEC for audit resolution and follow-up, in accordance with Office of Management and Budget (OMB) Circular A-50. Among other things, the draft regulation specifies the policies and procedures to be followed to ensure that corrective action is actually taken and verified in response to resolved audit recommendations, and to resolve any disagreements as to whether a proposed

corrective action plan satisfies the intent of the recommendation.

While the regulation was substantially completed in July 2008, the Executive Director has not approved issuance of the regulation. On January 27, 2009, a new SEC Chairman, Mary L. Schapiro, was sworn in. We hope the regulation will be approved promptly.

AUDITS AND EVALUATIONS CONDUCTED

Practices Related to Naked Short Selling Complaints and Referrals (Report No. 450)

Background

The OIG conducted an audit of Enforcement's policies, procedures and practices for processing complaints about naked short selling during the period from May 2008 to January 2009. Specifically, we conducted this audit to assess whether Enforcement had established and followed policies and guidelines that enabled it to respond appropriately to complaints and referrals, including those involving naked short selling. We coordinated our audit efforts with the GAO, which was conducting a broad review of the implementation of the Commission's short sale regulation, Regulation SHO. The audit was conducted in accordance with the generally accepted government auditing standards.

Our audit found that the majority of the complaints that Enforcement receives from the public come through its Enforcement Complaint Center (ECC) e-mail system. The ECC is staffed by four members from the Office of Internet Enforcement (OIE). The

staff consists of three attorneys and a program analyst, who screen incoming complaints and then forward them to headquarters and regional office Enforcement attorneys for further investigation. Of the approximately 1.38 million e-mail complaints that the ECC received from January 1, 2007 to June 1, 2008, approximately 5,000 pertained to naked short selling.

Enforcement also receives complaints through its complaints, tips and referrals (CTR) system. The SEC implemented the CTR system in 2005 to improve record-keeping and to follow up on complaints that were received outside the ECC mechanism. CTRs received by Enforcement headquarters staff are collected into a CTR database that is maintained by OIE staff. Each regional office also maintains its own complaint information in the CTR database. Between January 1, 2007 and June 1, 2008, approximately 1,900 complaints received by Enforcement headquarters and regional office staff were entered into the CTR database.

Enforcement also receives referrals of possible securities law violations from the Self-Regulatory Organizations (SROs). The SROs send the referrals to Enforcement through an automated SRO Market Referral System, which is monitored by Enforcement's Office of Market Surveillance (OMS). Enforcement regards these referrals to be more reliable than complaints received directly from the public because the referrals are based on investigations conducted by SRO staff, who have access to state-of-the-art market monitoring resources. Based upon information obtained during our audit, we determined that the OMS received approximately 900 referrals from the SROs between January 1, 2007 and June 1, 2008.

Our audit focused on complaints pertaining to the practice of naked short selling. Short selling involves the sale of a security that a seller does not own, or a sale that is consummated by the delivery of a security that is borrowed by, or for the account of, the seller. A short seller believes that the price of the stock will fall, or is seeking to hedge against potential price volatility in securities he or she owns. If the price of the stock falls, the short seller buys back the stock at a lower price and makes a profit. If the stock price rises, however, the short seller will incur a loss. In the typical short sale transaction, the seller borrows stock from his or her brokerage firm and delivers the borrowed shares to the buyer within the standard settlement period, which currently is three business days.

A "naked short sale" occurs when the seller does not borrow securities in time to make delivery to the buyer within the standard three-day settlement period. As a result, the seller fails to deliver securities to the buyer when delivery is due. This is commonly known as a "failure to deliver" or "fail." Naked short selling is not necessarily a violation of the Federal securities laws or the Commission's rules. However, the SEC's Division of Trading and Markets has recognized that abusive naked short selling can have negative effects on the market, as fraudsters may use naked short selling to engage in illegal market manipulation (e.g., by selling stock short and failing to deliver shares at the time of settlement with the purpose of driving down the stock price).

The Commission has repeatedly recognized that naked short selling can depress stock prices and may have harmful effects on the market. The Commission adopted Regulation SHO to update short sale

regulation in light of numerous market developments since the short sale regulation was first adopted in 1938. Regulation SHO became effective on September 7, 2004, and compliance with the regulation began on January 3, 2005. More recently, the Commission instituted a number of emergency orders and amendments to Regulation SHO. These included, among others, a July 15, 2008 temporary emergency order that prohibited short sales in the securities of certain financial firms unless certain requirements were met, and a September 17, 2008 temporary rule that imposed enhanced delivery requirements on sales of all equity securities.

Results

Our audit found that despite the tremendous amount of attention that naked short selling has generated in recent years, Enforcement has brought very few enforcement actions based on conduct involving abusive or manipulative naked short selling. Moreover, only a small amount of naked short selling complaints are forwarded for additional investigation. Of approximately 5,000 naked short selling complaints received in the ECC from January 1, 2007 to June 1, 2008, only 123 (approximately 2.5 percent) were forwarded for further investigation. These were forwarded not because of the naked short selling allegations but because they pertained to ongoing investigations. None of these complaints resulted in any enforcement action although one complaint referenced a pending enforcement action involving naked short selling. Additionally, we found that only six of approximately 1,900 complaints that were entered into Enforcement's CTR database during the period we examined alleged naked short selling. Based on data that was available to us, these complaints did not lead to any

enforcement actions. Also, the OIG was informed that none of the approximately 900 SRO referrals that OMS received between January 1, 2007 and June 1, 2008, involved naked short selling.

Our audit determined that Enforcement's existing complaint receipt and processing procedures hinders its ability to respond effectively to naked short selling complaints and referrals. We further found that the ECC's written policies and procedures do not include specific triage steps for naked short selling complaints, while they do include procedures for an in-depth analysis of several other categories of complaints (e.g., spam driven manipulations, unregistered online offerings and insider trading). Hence, we found that these procedures cause naked short selling complaints to be treated differently than other types of complaints that are received and processed.

Moreover, the ECC's policies and procedures expressly instruct staff, as a general matter, not to forward investigation complaints based on the data that is obtained from "Level II" trading terminals (which show only the best bid and ask prices and number of shares available). Because many investor complaints on naked short selling are based on information obtained from Level II trading screens, no triage is performed on these complaints and they are automatically not forwarded to Enforcement staff, unless they pertain to an existing Enforcement matter. Our audit also disclosed a risk that naked short selling complaints with potential merit may be eliminated from further consideration during the initial complaint screening process because supervisory reviews are not performed on the initial screening.

Our audit further revealed that improvements are needed to the CTR

process, both at headquarters and the regional offices, to ensure the appropriate handling of all incoming complaints, including those involving naked short selling. We found that currently there is no uniform set of procedures for the receipt and processing of CTRs and there is no division-level oversight of the CTR program. Presently, there are different procedures for processing CTRs for headquarters and the regional offices. The OIG also discovered that some regional offices have their own written CTR procedures, while others have informal, unwritten CTR practices. We also found that regional office procedures are inconsistent as to when and whether complaints are entered into the CTR database. Depending on where within the SEC a complaint is received, complaints, including those involving naked short selling, may be treated inconsistently due to the lack of uniform complaint procedures and division-level oversight.

Additionally, our audit found that neither the headquarters nor the regional offices are complying with the existing written CTR policies and procedures. We reviewed 82 headquarters CTR packages for the period from January 1, 2007 to June 1, 2008, to test for compliance with the headquarters CTR policies and procedures. According to the applicable policies and procedures, a complaint package should include the original complaint, a copy of the response that is sent to the complainant, and a completed CTR data form. The majority of the CTR packages that we reviewed were incomplete. Specifically, 67 percent (55 of 82) were missing responses to the complainant; 40 percent (33 of 82) were missing the CTR data form; and 10 percent (8 of 82) were missing the original complaint itself. We also found that one of the CTRs was not entered into the CTR database, and another CTR was only partially entered. We learned during our

audit that the OIE does not follow up with Enforcement staff to ensure that CTR packages are complete, oftentimes resulting in the OIE lacking adequate complaint documentation.

In order to determine compliance with the SEC's regional office's CTR procedures, the OIG sent a questionnaire to staff at all 11 regional offices. Existing CTR policies and procedures applicable to the regional offices require that supervisors at the Senior Officer (senior executive service equivalent) level conduct monthly CTR reviews. The regional offices' responses to our questionnaire revealed that only five regional offices performed the required monthly CTR reviews. Two regional offices performed the reviews on a less frequent basis, while three regional offices did not perform the monthly reviews because senior officials were involved with the CTRs throughout the process, or lower level officials were considered to be responsible for CTR judgments. One regional office that was previously a district office, forwarded its CTRs to another regional office for review.

Our audit also found that Enforcement's current automated complaint tracking systems, which are primarily the ECC e-mail system and the CTR database, need to be improved to ensure that complaints are appropriately processed and tracked. In addition, our audit revealed that a database that the OIE previously developed to track the results of complaint referrals was no longer in use due to technical difficulties that were encountered with the system. As a consequence, the OIE currently does not have the ability to track electronically whether the various types of complaints that are referred to Enforcement staff result in opening an informal inquiry or a formal investigation.

Recommendations

The OIG issued its final report on March 18, 2009, and identified 11 recommendations that, if implemented, will strengthen Enforcement's controls over complaints, including those pertaining to naked short selling. Specifically, we recommended that Enforcement:

- Develop written in-depth triage analysis steps for naked short selling complaints, as it has for complaints involving other types of securities law violations, such as spam-driven manipulations and insider trading.
- Revise written guidance to the ECC staff to ensure that naked short selling complaints based on information obtained from "Level II" computer screens are given a proper level of scrutiny and referred for further investigation where appropriate.
- Add naked short selling to the list of categories of complaints on the Commission's public webpage that solicits complaints from the public and develop an online complaint form specifically tailored to naked short selling complaints.
- Develop and implement policies and procedures providing for supervisory review of a sample of e-mails that are not forwarded for further review as a result of the initial screening process.
- Develop uniform written policies and procedures for the CTR program at headquarters and the regional offices, including a requirement for when complaints should be entered into the CTR database (e.g., upon receipt) and a provision for consistent, periodic supervisory reviews of CTRs.
- Designate an office or individual at headquarters to provide nationwide oversight for the CTR program.
- Require the OIE to perform follow-up to ensure that all CTR packages that are forwarded to the OIE contain complete documentation concerning the complaint, and that all CTRs are entered into the CTR database.
- Require Enforcement's regional office senior officials to perform monthly CTR reviews, as required by the regional office CTR procedures.
- Improve the analytical capabilities of the ECC's e-mail complaint system, including its search and report generation capabilities, as well as its ability to translate foreign-language e-mails.
- Improve the CTR database to include additional information about complaints, e.g., by adding data fields to document supervisory and senior staff review, to increase its searching and report generating capabilities, and to resolve problems with regional office access to the database.
- Ensure that the OIE updates and resumes using its previous complaint referral tracking system, or develops a new system for tracking information on the results of complaint referrals.

Enforcement concurred with only one of the report's 11 recommendations, stating that the naked short selling complaints it receives generally do not include sufficient information to warrant pursuing the complaints and that it is reluctant to expend additional resources to investigate such complaints. Enforcement indicated, however, that it is willing to perform supervisory sampling and review of complaints that are eliminated at the initial

screening stage. Enforcement also stated that because the Chairman of the SEC is currently engaged in an agency-wide effort to determine how tips and complaints are handled in the various divisions and offices, the appropriate time to consider the OIG's recommendations would be after that comprehensive review has been completed.

The OIG provided a response to Enforcement's comments, expressing its disappointment with Enforcement's decision not to take these necessary actions to ensure that naked short selling complaints are given a proper level of scrutiny. We noted that we will work closely with the Chairman's efforts to review internal procedures used to evaluate tips, complaints, and referrals for the agency to ensure that our recommendations are appropriately implemented. After the OIG report was issued, six United States Senators wrote to the Chairman, stating their concern about Enforcement's reluctance to agree with the OIG's recommendations and urging the Chairman to clarify the Commission's commitment to end abusive short selling.

Division of Enforcement's Disgorgement Waivers (Report No. 452)

Background

The OIG contracted the services of Regis and Associates, PC (Regis), an independent public accounting firm, to conduct an audit of the Enforcement's disgorgement waivers that were granted in Fiscal Years 2006 to 2008. The audit was conducted as a follow-up to two previous OIG audit reports (Report Nos. 311 and 384) on disgorgement waivers that were issued in January 2001 and January 2005, respectively. The overall objectives of conducting the audit were to:

- Evaluate the compliance of Enforcement's disgorgement waiver process with governing policies and procedures and identify possible improvements;
- Determine whether defendants/respondents misrepresented their financial position to Enforcement in seeking disgorgement waivers;
- Quantify the defendants'/respondents' actual amount of undisclosed assets, overstated liabilities, underreported income and overstated expenses; and
- Follow up on prior OIG recommendations.

Regis conducted this audit from June 2008 to September 2008 in accordance with the generally accepted government auditing standards.

Enforcement staff conduct investigations into possible violations of the Federal securities laws, and prosecute the SEC's civil suits in Federal courts, as well as its administrative proceedings. In civil suits, the SEC seeks injunctions, which are orders that prohibit future violations. A person who violates an injunction is subject to a fine or imprisonment for contempt. In addition, the SEC can seek civil monetary penalties and the disgorgement of illegal profits, or losses avoided. The courts may also bar or suspend defendants from acting as corporate officers or directors. Disgorgements represent ill-gotten gains, or losses avoided, resulting from individuals or entities violating the Federal securities laws.

The SEC can also bring a variety of administrative proceedings, which are heard by administrative law judges and, if appealed, by the Commission. Proceedings seeking a cease and desist order may be instituted

against any person who violates the Federal securities laws. The Commission may order a respondent to disgorge ill-gotten funds in these proceedings. With respect to regulated entities (e.g., brokers, dealers, and investment advisers) and their employees, the SEC may institute administrative proceedings to revoke or suspend registration, or to impose bars or suspensions from employment. In proceedings against regulated persons, the Commission is authorized to order violators of Federal securities laws to pay civil penalties, as well as disgorgement of ill-gotten gains or losses avoided.

Enforcement is responsible for reviewing disgorgement waiver requests. The SEC seeks disgorgements to ensure that securities law violators do not profit from their illegal activities. When appropriate, the disgorged funds are returned to injured investors. Penalties are also levied on violators of Federal securities laws as appropriate. Disgorgements and penalties may be ordered in either administrative proceedings or civil actions, and the cases may be settled or litigated.

Enforcement can recommend to the Commission that disgorgements be completely or partially waived based on a defendant's/ respondent's demonstrated inability to pay, among other policy reasons. Enforcement's procedures require staff who are reviewing waiver requests to request sworn financial statements (SFS) from defendants/ respondents. Defendants/ respondents are required to attach copies of the following documents to their SFSs that are submitted to Enforcement:

- Federal income and gift tax returns, including related schedules and attachments;

- Bank account statements;
- Credit card and brokerage account statements, insurance policies, and mortgage documentation;
- Any financial statements prepared by the defendant/respondent, including bankruptcy schedules; and
- Documents evidencing current loans.

Additionally, when defendants/ respondents request a waiver, Enforcement staff are required to conduct a credit check of the defendants/ respondents, and to perform Internet or LexisNexis searches on them, as well as their relatives and friends in certain instances. These searches are designed to corroborate the defendants'/ respondents' stated financial condition and to identify hidden assets, overstated liabilities, unreported income, and overstated expenses. The financial statements that defendants/ respondents provide show their assets, liabilities, income and expenses. In instances where the Commission waives a disgorgement request, penalties are not assessed against the defendants/ respondents.

In FY 2006, the SEC initiated 914 investigations, 218 civil proceedings, and 356 administrative proceedings. These proceedings covered a wide range of issues. Major areas of enforcement activity included corporate financial fraud, including abusive backdating of stock options; compliance failures at self-regulated organizations and broker-dealers; and fraud related to mutual funds. During FY 2006, the SEC's Enforcement cases resulted in more than \$3.3 billion in disgorgements and penalties that were ordered against securities law violators. Whenever practical, the Commission sought to return funds to harmed investors through

the use of the “fair fund” provision of Section 308 of the Sarbanes-Oxley Act of 2002 (15 U.S.C. § 7246).

According to Enforcement’s Phoenix disgorgement tracking system, for FY 2006, FY 2007, and from October 1, 2007 to May 31, 2008, the Commission granted disgorgement waivers totaling \$72.6 million, \$67.8 million, and \$37.1 million, respectively.

Results

The audit found that while progress has been made in Enforcement’s disgorgement waiver process, some concerns, including deficiencies the OIG previously identified, still remained. The audit examined 63 investigations in which 72 defendants/respondents received disgorgement waivers based on their inability to pay totaling \$123,070,682 for the period from October 1, 2005 through May 31, 2008.

The audit found three cases in which full waivers totaling \$841,580 were granted, even though the defendants/respondents appeared to have the ability to pay at least some portion of the disgorgement amounts and, therefore, either partial payment and/or a payment plan should have been considered. Specifically, the audit determined that these defendants/respondents had substantial assets, good credit scores, positive net worth, and/or positive monthly net income.

The audit also revealed two instances where the defendants’/respondents’ assets were not accurately reported on the SFSs. The SFSs submitted by defendants/respondents are the foundational documents in the disgorgement waiver review process. These documents contain the assertions of the

defendants/respondents regarding their assets, income, liabilities, and expenses. Specifically, the audit identified two defendants/respondents who underreported their assets totaling at least \$386,238. Our analysis was based on the inability to reconcile the amounts reported on the SFSs to the corresponding supporting documentation and information that was obtained through public database searches.

In addition, the audit found that in 56 instances, Enforcement did not follow its internal procedures requiring its staff to obtain adequate supporting documentation for dollar amounts reported on the defendants’/respondents’ SFSs. Further, the staff did not always document why certain procedures were not followed (e.g., why certain documentation was not obtained). Following the established procedures is important because it helps to ensure that waiver requests are only granted to persons with a proven inability to pay.

Of the waivers reviewed, assets such as cash, securities, real estate, automobiles, and notes receivable that were reported on the SFSs for seven defendants/respondents were not supported by documentation, such as bank statements and asset titles. The liabilities reported on the SFSs for 21 defendants/respondents were not supported by documentation such as mortgage statements and credit card statements. Moreover, income and expense information reported on the SFSs were not always supported by needed support documentation.

The audit further found 24 instances where the checklists that are required for maintaining, reviewing and confirming the SFSs were either not included in the file, or

not signed as required. The audit also found 34 instances where credit reports, bank statements and income tax returns were not provided or obtained, or signed as required.

Finally, the audit found that Enforcement had no formal or comprehensive training programs for its staff who are responsible for reviewing disgorgement waiver requests. Formal training for those staff would provide them with a comprehensive understanding regarding the disgorgement waiver review process. Given the complexity and the level of sensitivity of disgorgement waivers, it is critical that the staff who review waiver requests are provided with the requisite resources, including adequate training in new technology, skills, and applicable regulatory standards.

Recommendations

The final audit report was issued on February 3, 2009, and contained eight recommendations that are needed to improve Enforcement's disgorgement waiver process. The report further identified \$386,238 in total cost savings that represented underreported assets.

The report recommended that Enforcement should: (1) ensure that staff comply with its procedures and consider partial payments plans and partial waivers where defendants/respondents have the ability to pay some portion of the disgorgement amount; (2) undertake action to ensure its staff review defendants'/respondents' financial information for accuracy prior to recommending a disgorgement waiver; (3) clarify its policies regarding when supporting documentation should be obtained and retained for assets, liabilities, income and expenses shown on the

SFSs; (4) ensure defendants/respondents SFSs are retained, signed and authorized; (5) take appropriate action to make certain checklists are always retained and signed by a supervisor; (6) implement adequate internal controls to ensure required documentation such as credit reports, bank statements, and income tax returns are retained in the defendants'/respondents' case files; (7) review its internal control policies to ensure public database searches are performed; and (8) clarify its internal control policies and procedures to ensure staff attorneys are appropriately trained in the disgorgement waiver process. Management concurred with all eight of the report's recommendations.

Regulation D Exemption Process (Report No. 459)

Background

The OIG reviewed the Division of Corporation Finance's (CF) process for assessing whether issuers of securities appropriately use Regulation D exemptions from the registration requirements of the Securities Act of 1933 (Securities Act). The Securities Act generally requires each sale of a security to be registered with the SEC. However, the law contains certain statutory exemptions and allows the SEC to establish additional regulatory exemptions from registration when it determines that securities registration is not required for the protection of investors because of the small size or limited nature of the offering. In 1982, the SEC adopted rules known as Regulation D, which contain exemptions from Federal registration requirements for limited offerings of securities.

Companies that sell securities in reliance on an exemption pursuant to Regulation D are required to file an SEC Form D notice

with the SEC. Companies may also be required to file a Form D with their respective state regulators. The Form D serves as the official notice of an offering of securities that is made without being registered under the Securities Act, in reliance on an exemption that is provided by Regulation D. The information in the Form D assists the SEC and state securities regulators to administer the securities laws. A company is required to report on Form D detailed information about the nature of an offering, such as the amount of money intended to be raised, the type of exemption on which the company is relying, and the date of the first sale of securities. Regulators can use this information to determine whether a company acted in accordance with the information it reported on the Form D, appropriately relied on the exemption claimed, and timely filed a Form D. Both public and non-public companies report information using Form D.

On September 15, 2008, the SEC introduced a revised Form D to clarify and simplify the reporting process and to eliminate the reporting of unnecessary information. Also, as of September 15, 2008, companies were given the option to file Form D electronically with the SEC, as opposed to sending the form to the SEC in hard copy. As of March 16, 2009, the SEC required all Form D filers to file the form electronically. Also on March 16, 2009, the SEC launched a new system to enable SEC staff to analyze Form D information in the aggregate and to develop management reports.

The OIG initiated this audit because of the high dollar amount of capital that is raised through the Regulation D exemption process. The objectives of the audit were to evaluate the effectiveness of SEC's oversight of the

Regulation D exemption process and to identify areas for improvement. The audit was conducted in accordance with the generally accepted government auditing standards.

Results

Overall, the audit found that CF does not generally take action when its staff learn that companies have not complied with the Regulation D exemption requirements. Further, CF does not substantively review the more than 20,000 Form D filings that it receives annually, which the OIG estimated were used to raise \$609 billion dollars of capital in 2008.

Based on the OIG's analysis and review of Office of Compliance Inspections and Examinations (OCIE) examination reports, we identified several instances of misuse, non-compliance, and illegal acts regarding the Regulation D exemptions, as well as errors in Form D filings. Thus, we concluded that monitoring compliance with the requirements of the Regulation D exemptions is important to ensure the integrity of the Form D filing process and to ensure that companies appropriately use the exemptions. Taking action when deficiencies are identified would help to achieve the SEC's mission of protecting its investors.

We also believe that the Form D filings contain valuable information regarding the size and nature of the reporting firms (including hedge funds), the amount of capital being raised, the types of exemptions that companies use, and the number of investors that are involved in Regulation D issuances. However, SEC staff generally do not utilize this information, which, if aggregated, could

identify the size and nature of Regulation D offerings. Using a new database that the SEC launched on March 16, 2009, the SEC now has the capability to analyze and make effective use of the Form D information.

Based on our review of Form D, we determined that certain revisions should be made to the form to better ensure that potential investors are not misled by information in a form filing and to further clarify the information that is reported on the form.

Our audit also found that firms lack formal, written guidelines from the SEC on filing disqualification waivers pursuant to Rule 505 of Regulation D. Companies may seek these waivers when they are found to be non-compliant with certain provisions of the securities laws and, therefore, become disqualified from relying on Rule 505. CF management told us that initial waiver requests are often deficient and firms typically need to redraft and resend the waiver requests to CF. Firms occasionally contact CF seeking written guidance on this process, but CF has not issued any formal written guidance to describe how firms can apply for the waivers and when they are appropriate. Instead, CF provides oral guidance and refers requestors to samples of successful waiver requests that are on the SEC's website.

Additionally, the audit determined that the OIT and CF did not timely or effectively simplify the SEC's Electronic Data Gathering and Retrieval (EDGAR) authentication process for new filers, as was expected. SEC officials estimated that approximately 19,000 new filers will file Form D electronically as a result of the new electronic filing requirement

that took effect on March 16, 2009, making this the EDGAR system's second largest group of new filers. We found that the current EDGAR authentication process is overly complex and time-consuming. In a Commission meeting in December 2007, the OIT and CF agreed to begin working together to simplify this process. In fact, CF informed us that its staff had worked with OIT staff for several years to simplify the process, even prior to the Commission meeting. However, the simplified process, which took effect on March 16, 2009, merely consists of allowing new filers to attach a notarized PDF document to an online submission to the SEC, as opposed to faxing the document to the SEC, as was previously required. Thus, this new process is inadequate because it did not resolve many of the existing problems with the EDGAR authentication process. Moreover, in our opinion, and according to OIT and CF staff, an adequate simplification process should have been implemented prior to March 16, 2009. SEC staff noted that they plan to further simplify the EDGAR authentication process.

Finally, the audit found that the SEC needs to further improve its coordination with state regulators to ensure greater uniformity in Federal and state securities regulation. In particular, further coordination is needed to assist the North American Securities Administrators' Association (NASAA), an organization that is comprised of state securities regulators, in developing an electronic system that can be linked to EDGAR and will allow companies to file Form D with the states electronically. Currently, entities can file Form D electronically only with the Commission and must file paper Form Ds with the states.

Recommendations

The OIG's final report was issued on March 31, 2009, and contained 17 recommendations for improvement in the Regulation D process. The report recommended that CF and the Commission better ensure that companies comply with Regulation D and take appropriate action when CF finds that companies have materially misused the Regulation D exemptions. For example, we suggested that CF could make additional referrals to Enforcement or contact companies that fail to file a Form D, or otherwise misuse the Regulation D exemptions. We also recommended that CF establish a process to review Form D information in the aggregate and develop meaningful management reports.

We further recommended that CF reintroduce its Early Intervention Program, which was intended to combat fraud and other securities law violations that were perpetrated through the Internet. Through this program, CF staff actively looked for and sent letters to potential securities laws violators and often identified Regulation D abuses. According to CF, the program ended in 2005 due to a lack of staff resources. Reintroducing this program would provide CF with an additional opportunity to contact potential securities law violators, including issuers that misuse the Regulation D exemptions.

The OIG also recommended that CF should develop criteria to describe when it is appropriate to refer potential Regulation D abuses to Enforcement. We stated that CF should continue to discuss with the Chairman, the Commissioners and Commission senior staff the merits of the SEC's proposed rule

regarding Regulation D and any changes that should be made to this proposed rule. The proposed rule contains provisions that we believe would strengthen the Regulation D exemption process. In addition, CF should raise with the Commission the possibility of making the filing of Form D a required condition for entities to claim the Regulation D exemptions contained in Rules 504, 505 and 506. While Rule 503 of Regulation D requires the filing of a Form D, filing the form is not presently required to claim the Regulation D exemptions.

We also recommended that CF work with OIT to make certain changes to Form D to better ensure that potential investors do not rely on erroneous or misleading information in Form D filings and to further clarify the Form. One improvement includes adding a disclaimer to Form D stating that the SEC has not necessarily reviewed the information contained in the Form D and that the reader should not assume that the information in the Form is accurate or complete. We observed that other SEC filings contain similar disclaimers.

We also suggested that CF and OIT work together to further simplify the EDGAR authentication process for new EDGAR filers. In addition, CF should issue written public guidance on how firms may apply for disqualification waivers under Rule 505 of Regulation D. CF should also continue to improve its coordination with state regulators regarding Regulation D issues, and should provide additional guidance to entities on the Form D filing requirements. Finally, CF should implement the outstanding recommendations that were made in the OIG's prior audit report, which was issued in 2004.

CF fully concurred with ten of the report's recommendations and partially concurred with the remaining five recommendations that were directed to CF. The OIT, OCIE and Enforcement agreed with all of the recommendations that pertained to those units.

Review of the Commission's Restacking Project (Report No. 461)

Background

The OIG conducted a review of the SEC's restacking (changing the configuration of the layout of the divisions and offices) project, because of various complaints received from SEC staff that the restacking project was not properly approved or initiated, did not serve a useful purpose, and was a waste of SEC resources. We conducted our review from December 2008 to March 2009. The objectives of our review were to assess whether the restacking project was conducted in accordance with applicable policies and procedures and whether an appropriate analysis or study was conducted to determine if the restacking project was cost effective and beneficial to the agency.

In 2006, the SEC moved into new buildings at its headquarters location in Washington, D.C., known as the Station Place 1 and 2 buildings (Station Place). In May 2005, the SEC disclosed to a United States House of Representatives Subcommittee that it had identified unbudgeted costs of approximately \$48 million, attributable to misestimates and omissions of budget costs associated with the internal construction of the headquarters facility and improvements in newly-leased New York and Boston facilities.

As a result of this disclosure, the House Subcommittee requested that the GAO conduct a review of the circumstances that led to the unbudgeted costs. As a result of the review, the GAO made several recommendations, and the SEC indicated that it took action to implement GAO's recommendations. Notwithstanding the significant costs expended by the SEC in connection with the previous moves at headquarters, New York and Boston, including approximately \$48 million in unbudgeted costs, and criticism from GAO regarding the SEC's management controls over budget formulation and review, there was reportedly widespread sentiment in favor of restacking (i.e., changing the configuration of the layout of the divisions and offices) almost from the instant SEC staff moved into the new headquarters buildings.

The plan utilized when the SEC initially moved into its new headquarters buildings was a "vertical stack" configuration of staff, under which staffs of the SEC's divisions and offices were spread out on multiple floors. The purpose of this vertical configuration was to enable staff from various divisions and offices to commingle on the same floor, instead of keeping staff in a single division or office located close together on the same floor.

Almost immediately after the SEC decided to utilize this vertical approach, SEC managers decided that a horizontal approach was preferable, so that divisions and offices would not be split across multiple floors. Senior managers believed the vertical configuration impeded effective communication and collaboration among staff within divisions and offices. As a result, in or about February 2007, the Chairman asked the Executive Director to explore the idea of

restacking SEC staff, including performing a cost-benefit study.

The restacking project was approved in the second or third quarter of FY 2007 and included the relocation of approximately 1,750 employees on the second through the ninth floors of Station Place, in nine move phases. The initial government estimate for the restacking project in 2007 was \$2,332,000, but did not include any costs for construction. As of February 2009, the funding obligated in connection with the restacking project, including construction, was approximately \$3.19 million. As of November 2008, the total cost of the completed project was estimated to be \$3.9 million, which was reduced from an estimate of approximately \$4.6 million in June 2008. Also, the project's completion date was moved back nine months, from September 2008 to June 2009.

Results

Our review found that although a cost-benefit analysis was supposed to have been conducted, there is no record of any such analysis or a feasibility study being done. No survey or study was conducted to determine if the existing configuration was actually impeding communication. Also, a formal analysis was not performed to determine whether the cost and disruption caused by the project would outweigh the perceived benefits of improved communication. Further, according to information obtained during our review, the former head of the Office of Administrative Services (OAS) was not at all in favor of the project, but was given "marching orders" to go forward with it anyway.

During our review, we sent a survey to approximately 2,100 SEC staff in Station Place, as well as the Operations Center, to

obtain their views on how the restacking project to date has improved communication and effectiveness. The survey found that staff were largely satisfied with the locations of their workspace prior to the restacking. We also found that most of the staff did not feel dissatisfied with the time it took to communicate with either their co-workers or supervisors prior to the restacking, nor did they feel that the prior configuration of their office space impeded their productivity. In addition, the survey showed that staff who had already moved to their new permanent workspace felt, for the most part, that the move had no impact on their ability to communicate effectively or their productivity. Further, an overwhelming majority (81%) of SEC staff who responded to the survey felt that any benefits of the restacking project were not worth the costs and disruption to their work.

Additionally, our review found that prior to undertaking the restacking project, the SEC failed to comply with OMB's requirements and guidance for analyzing and justifying major capital investments and did not complete the form that had to be submitted to OMB for such projects. Our review also noted that the SEC's policies and procedures for space management, particularly in regard to headquarters facilities projects, are unofficial and quite sparse. Moreover, the single requirement in this document that would have applied to the restacking project does not appear to have been complied with.

We concluded, therefore, that there were serious questions about whether the restacking project was necessary and whether it has had, or will have, any meaningful impact on communication among or productivity of the staff. We also concluded that the SEC should have conducted a formal cost-benefit analysis of the restacking project prior to its

undertaking and, had such an analysis been prepared, it may have led to the conclusion that the restacking project was not worth the costs and disruption to the agency.

Recommendations

The OIG issued a report summarizing the results of its review on March 31, 2009, that included four recommendations. Specifically we recommended that the OAS carefully review the results of the OIG survey to determine if any changes should be made to the restacking project based upon the responses. We further recommended that the OAS conduct another survey after the restacking process has been fully completed to understand the effects and impacts of the project better and determine what, if any, changes should be implemented. In addition, we recommended that because the restacking project is still ongoing, the OAS should conduct appropriate analysis to complete and submit to the OMB the required capital planning documentation for the remainder of the project. Finally, we recommended that the OAS, in coordination with the Office of Executive Director and using SEC information technology capital planning requirements as a guide, develop and adopt guidance for space investments that is commensurate with OMB's guidance for capital investments. Management concurred with three of the report's four recommendations.

2008 Audit of Sensitive Payments (Memorandum Report No. 448)

Background

The OIG conducted a limited scope audit of sensitive payments in support of the GAO's audit of the Commission's FY 2008 financial

statements. Our work was done as a performance audit conducted in accordance with the generally accepted government auditing standards. Specifically, we assessed the effectiveness of controls over sensitive payments, which consist of a wide range of executive functions, including compensation, travel, official entertainment funds, unvouchered expenditures, consulting services, speaking honoraria and gifts, and executive perquisites. Controls over these payments to senior government executives are critical because these senior executives are vested with the public trust and hold positions with a high degree of decision-making authority in the Federal government. Within the SEC, senior government executives include the Chairman, the Commissioners, Administrative Law Judges and Senior Officers.

Results

Our audit of sensitive payments did not disclose any evidence of fraud and we concluded that overall, controls over sensitive payments were reasonable. However, we identified some specific areas that needed improvement.

In particular, the OIG's review of executive compensation revealed that several Senior Officers received sizeable merit pay increases and bonuses. However, the agency did not always have adequate documentary support to justify all approved compensation that was awarded to Senior Officers. Our initial testing of executive compensation revealed that two Senior Officers in our sample received substantial salary increases (based on merit), and/or lump sum bonuses (one for \$20,000 and one for \$10,000). We later expanded our executive compensation fieldwork and requested information on all Senior Officer merit pay increases and

bonuses that were approved and awarded during FY 2008. We were provided an award spreadsheet that showed that a total of seven Senior Officers received merit pay increases of \$20,000 or more and bonuses of \$20,000 or more. These merit pay increases and bonuses ranged from combined totals of \$44,657 to \$85,082. Specifically, one Senior Officer received a \$24,657 merit increase; another received a \$55,720 merit increase, and five received \$65,082 in merit increases. In addition, all seven received \$20,000 lump-sum bonuses. Although we did not find any evidence of fraud or payments that went over the established limits or budgeted amounts, we believe that justification is needed to support awarding such significant dollar amounts (merit increases of \$20,000 or more, or bonuses of \$20,000 or more).

The OIG's audit also revealed that prior reviews of SEC sensitive payments conducted by the GAO found that lower level employees had certified senior executives' time and attendance reports. The GAO identified this issue as an internal control weakness that warranted management's attention on at least two prior occasions. Our review found that this practice was still occurring, notwithstanding the GAO's previous findings.

Further, the OIG's review of executive travel uncovered two occasions involving foreign travel where it appeared the SEC underpaid Senior Officers for reimbursement of their expenses. The OFM processed the reimbursements based on incorrect currency conversion rates used by the travelers, which resulted in the travelers being underpaid. In both cases, the travelers calculated their reimbursements using a daily conversion rate for each day of their stay at a particular location. OFM officials informed the OIG that the Office does not have any written

policy describing how foreign travel expenses should be calculated. However, OFM's practice is to calculate the traveler's hotel expenses and value added tax using either the currency conversion rate on the credit card statement, or the rate as of the traveler's hotel checkout day. We determined that the two Senior Officers were underpaid for foreign travel expenses and OFM should reimburse them for the underpaid amounts. We further determined that OFM should revise its policies and procedures to provide guidance to SEC employees on how to calculate reimbursable foreign travel expenses.

Additionally, the audit found that reception and representation expenditures during FY 2008 were within the legal limit and were properly approved and classified. These costs typically are associated with entertaining visiting dignitaries and State functions. The fund amounts are limited by law and cannot exceed \$3,500.

Further, the OIG found that the SEC's policies and practices concerning the receipt and acceptance of gifts are in accordance with the requirements of the Standards of Ethical Conduct for Employees of the Executive Branch, but the OIG believes that the Ethics Office should maintain a record of the prohibited gifts returned by SEC employees of which it has knowledge.

The OIG's review of contracting and consulting services, which included an examination of six contracts in effect as of May 31, 2008, identified no conflicts of interest. However, we discovered that not all required documentation was located in the contract files. In particular, a Justification and Approval was required for two of the six contracts we reviewed, but was missing from one of the files.

The OIG also found that: (1) the SEC did not authorize or process any unvouchered expenditures in FY 2008; (2) the amounts spent for executive perquisites were within the allotted limits; and (3) Senior Officers' financial disclosure forms were submitted and reviewed in accordance with the Office of Government Ethics regulations at 5 C.F.R. Part 2634, with the exception of one Senior Officer who was granted a 45-day extension to file the form.

Recommendations

The OIG issued its final report on March 27, 2009. To improve the SEC's internal controls over sensitive payment areas, the audit report made six recommendations. Specifically, the report recommended that: (1) the Chairman's Office provide detailed justifications for all Senior Officer merit pay increases of \$20,000 or more, or bonuses of \$20,000 or more; (2) senior executives be notified in writing that their time and attendance must be certified by senior personnel of equal or higher grade; (3) OFM revise its policies and procedures to add guidance for calculating foreign travel reimbursements; (4) OFM reimburse travelers amounts they were underpaid due to currency conversion and other errors; (5) the Ethics Office maintain a record of returned gifts of which it has knowledge; and (6) contracting files contain complete documentation and indicate which documents are not required to be included in the files.

Management concurred with four of the report's recommendations, partially concurred with one recommendation, and did not concur with one recommendation.

Audit of Public Transportation Benefit Program (Report No. 456)

Background

The OIG conducted an audit of the SEC's Public Transportation Benefit Program (transit benefit program) during the period from November 2008 through February 2009, in accordance with generally accepted government auditing standards. The objectives of the audit were to determine if the SEC had sufficient policies and procedures in place to ensure compliance with applicable laws, regulations, and other requirements, and to assess whether employees were complying with transit benefit program participant requirements.

The SEC's transit benefit program, which originated in 1992, provides financial incentives to employees to commute to and from work by means other than single occupant vehicles. The Commission spent approximately \$1.3 million in FY 2007 and \$1.6 million in FY 2008 on the transit benefit program. As of July 2008, approximately 1,655 headquarters employees and 1,067 regional office employees participated in the transit benefit program. To assist in administering the program, the SEC entered into an interagency agreement with the Department of Transportation (DOT) that covers the headquarters location, as well as two regional offices.

Results

The audit found that the SEC has established some management controls over the transit benefit program. Nonetheless, we found that there are several areas in which significant improvements are needed.

Specifically, the audit found that the transit benefit application form and application process need to be strengthened to ensure compliance with OMB internal control guidelines. In addition, the audit found that transit benefit program participants were not always timely removed from the DOT's transit database after they separated from the SEC.

Consequently, the audit found that some employees inappropriately collected benefits totaling \$624 after leaving the SEC. While the audit generally found that transit benefit program participants were complying with the program requirements, the audit also found that some participants did not adjust benefits when teleworking or taking extended leave. Further, the OHR was unable to provide complete transit application data for nearly 50 percent (24 of 50) of the transit benefit program participants in our sample that we selected to test compliance with program requirements.

Recommendations

The OIG issued its final audit report on March 27, 2009. To improve and strengthen internal controls over the transit benefit program, the OIG's report made ten recommendations. Specifically, the report recommended that the SEC: (1) revise its transit application and application process to ensure they meet OMB internal control guidelines; (2) conduct periodic training for staff responsible for verifying transit participants' eligibility and commuting costs; (3) require transit benefit program participants to recertify annually their eligibility and commuting costs; (4) implement a process to obtain data routinely on separated SEC employees to ensure they are promptly removed from the active transit database;

(5) pursue collection of \$394 in benefits erroneously collected by transit benefit program participants after they separated from the SEC; (6) ensure complete transit files are maintained for all participants; (7) conduct periodic internal reviews of participants who are on extended leave and/or frequently telework to ensure they are properly reducing benefits; (8) remind participants that they are required to reduce benefits if they are on extended medical or personal leave, travel, and any other situation that causes their commuting costs to be less than the amount of benefits they are eligible to receive in the applicable month(s); (9) seek recovery of the estimated \$225 in overpayments erroneously collected by participants while they were on extended leave; and (10) implement additional management controls over regional office transit benefit program operations to ensure they are in compliance with applicable requirements.

SEC management concurred with all ten recommendations and stated they would take actions to implement the recommendations. In several instances, SEC management had begun working on correcting the problems.

OASIS System Report - 2008 FISMA (Report No. 463)

In June 2008, the OIG contracted with Electronic Consulting Services, Inc. (ECS) to assist with the completion and coordination of the OIG's input to the SEC's response to OMB Memorandum M-08-21. That memorandum provides instructions and templates for meeting the FY 2008 reporting requirements under the Federal Information Security Management Act of 2002 (FISMA), Title III of Pub. L. 107-347.

The objective of this evaluation was to review the OCIE Advisor Intelligence System (OASIS) and to assess the SEC's compliance with security controls that are prescribed by the National Institute of Standards and Technology (NIST) Special Publication 800-53A. NIST 800-53A was developed in order to promulgate standards, guidelines, and other publications to assist Federal agencies in implementing the FISMA and to manage cost-effective programs to protect their information and information systems. NIST 800-53A prescribes several controls pertaining to, for example, access to system and information integrity, and organizes security controls into classes and families for ease of use. There are three general classes of security controls (i.e., technical, operational, and management) and 17 security control families. Each family contains security controls that are related to the security functionality of the family.

The OASIS application provides extensive integrated search capabilities to perform fact finding on certain entities and can generate alerts and send e-mails to specific OCIE users and staff in the SEC's regional offices. OASIS synthesizes information found in data sources about an entity and/or its employees, and then generates dashboard reports specifically related to investment advisers, investment companies, hedge funds, transfer agents, and administrators.

Specifically, ECS's assessment of controls within the OASIS found that the SEC:

- Passed 13 of 20 Access controls that pertain to mechanisms and procedures that are used to control access to information systems.
- Complied with all the Awareness and Training controls for security training and awareness activities.
- Fully complied with the Audit and Accountability controls that contain safeguards that are used to record user interactions with the system to ensure accountability.
- Fully complied with the Certification and Accreditation (C&A) and Security Assessments controls pertaining to C&A and security policies and requirements.
- Fully complied with all the Configuration Management controls that are used to control the hardware and software configuration of an information system.
- Met all the Contingency Planning control requirements which are comprised of efforts that are undertaken to prepare for man-made and/or natural disaster which may affect the SEC's information systems.
- Was in full compliance with the Identification and Authentication controls that identify and authenticate users.
- Fully complied with all the Incident Response controls that refer to the processes and procedures that are implemented in response to an incident.
- Fully complied with the Media Protection family of controls that includes controls related to protecting the system media.
- Implemented the Planning controls that are related to information systems security planning for the system and was in full compliance with the requirement to develop and implement a security plan.
- Complied with the Personnel Security controls that pertain to the security of systems personnel.

- Complied with all the Risk Assessment controls that are used to estimate the threats and risks to an information system.
- Complied with the Systems and Services Acquisition controls which consist of procedures used to purchase and operate the information system.
- Fully complied with the System and Communications Protection controls that apply to the protection of information transmitted within and outside the information system.
- Fully complied with all System and Information Integrity controls that are implemented to ensure the stability and integrity of the information system.

The evaluation of OASIS revealed there were no significant security issues or areas of non-compliance. However, we identified areas where the system must be further evaluated to ensure that additional security risks are properly mitigated before the system's exposures increase.

The final report was issued on March 24, 2009, and contained three recommendations for improvements to the OASIS system, including an evaluation of OASIS's Access controls, Access Management and Information Flow Enforcement controls. Management agreed with all of the report's recommendations.

CTR System Report - 2008 FISMA (Report No. 462)

In June 2008, the OIG contracted with ECS to assist in another aspect of the completion and coordination of the OIG's input to the SEC's response to OMB Memorandum M-08-21.

The objective of this evaluation was to review the CTR system and to assess the SEC's compliance with security controls that are prescribed by NIST 800-53A. The CTR system was originally called the Enforcement Contact Tracking System (ECTS), and the name was changed at Enforcement's request. It is used to track complaints, tips and referrals that are received from the public.

ECS's assessment of controls within the CTR system found that the SEC:

- Passed 15 of 20 Access controls that pertain to mechanisms and procedures that are used to control access to information systems, and has established an effective Access control program.
- Complied with all the Awareness and Training controls for security training and awareness activities.
- Fully complied with the Audit and Accountability controls that contain safeguards that are used to record user interactions with the system to ensure accountability.
- Fully complied with the Certification and Accreditation (C&A) and Security Assessments controls pertaining to C&A and security policies and requirements.
- Fully complied with all the Configuration Management controls that are used to control the hardware and software configuration of an information system.
- Met all the Contingency Planning control requirements that are comprised of efforts that are undertaken to prepare for man-made and/or natural disaster which may affect the SEC's information systems.
- Was in full compliance with the Identification and Authentication controls that identify and authenticate users.

- Fully complied with all the Incident Response controls which consist of the processes and procedures that are implemented in response to an incident.
- Fully complied with the Media Protection family of controls that include controls related to protecting the system media.
- Implemented Planning controls related to information systems security planning for the system and was in full compliance with the requirement to develop and implement a security plan.
- Complied with the Personnel Security controls that pertain to the security of system's personnel.
- Complied with all the Risk Assessment controls that are used to estimate threats and risks to an information system.
- Complied with the Systems and Services Acquisition controls which consist of procedures that are used to purchase and operate the information system.
- Fully complied with the System and Communications Protection controls that apply to the protection of information transmitted within and outside the information system.
- Fully complied with all System and Information Integrity controls that are implemented to ensure the stability and integrity of the information system.

The final report was issued on February 27, 2009. Our evaluation of the CTR system did not reveal any significant security issues or areas of non-compliance, and the report did not make any recommendations.

PENDING AUDITS AND EVALUATIONS

The SEC's Role and Oversight of the Nationally Recognized Statistical Rating Organizations

The Nationally Recognized Statistical Rating Organizations (NRSRO), which are credit rating agencies that have been approved by the Commission, may have played a critical role in the current economic crisis and have been criticized in the past when certain high profile issuers defaulted on their debt payments. In September 2006, the Credit Rating Agency Reform Act (Act) was passed, granting the Commission formal oversight authority over NRSROs. The purpose of the Act was to improve accountability, transparency and competition in the credit rating agency industry. The Commission continues to conduct additional rulemaking in response to issues related to the involvement of NRSROs in the current economic crisis.

Given the importance of NRSROs, we initiated this audit in accordance with our audit plan. The audit's objective was to identify improvements in the SEC's oversight of NRSROs. The audit focused on the implementation and compliance with the Act and Commission rules. We also reviewed the SEC's history with NRSROs to assess the SEC's efforts to implement the Act's accountability, competition, and transparency objectives. The OIG expects to issue its audit report during the next semiannual reporting period.

The OIG's audit methodology included reviewing the OCIE'S NRSRO examination reports, Congressional testimony, Commission hearings (i.e., roundtables), the Division of Trading and Markets' Action Memoranda, SEC staff studies, academic papers, and

international standards (i.e., the International Organization of Securities Commissions' Code of Conduct and the proposed European Rules). We also conducted interviews of SEC staff and performed compliance testing. We plan to provide several recommendations pertaining to regulatory and policy issues and identifying specific areas in which oversight of NRSROs can be improved.

The Office of Administrative Services' Procurement and Contract Management Functions

The SEC's Office of Acquisitions (OA), within the OAS, is responsible for the agency's contract and procurement activities and processes, and is guided by the Federal Acquisition Regulation (FAR) in performing those functions. The OA's procurement and contract management functions include overseeing the receipt of requisitions from customers, identifying appropriate vendors and ensuring reasonable pricing, and awarding and administering contracts. The OA consists of three contracting branches and each branch is overseen by a contracting officer.

The OIG has contracted with an Independent Public Accountant to conduct an audit of the SEC's procurement and contracting function. The objectives of the audit are to identify the population of the SEC's contracts and other procurement vehicles; determine if cost reimbursable contracts have been properly closed out in accordance with the FAR and assess whether costs were allowable, allocable, and reasonable; determine if the procurement activities at SEC regional offices are effectively managed and the individuals performing the procurement activities at these offices are properly trained in accordance with OMB

requirements; determine whether OAS has an adequate migration plan for transitioning from the current manual procurement system to its newly-acquired electronic procurement system; and determine whether OAS overall has adequate controls over its contracting and procurement functions.

The scope of the review includes reviewing policies and procedures governing the procurement and contracting processes and functions; conducting interviews and walk-through procedures with appropriate OAS personnel to document and observe actual procurement processes in place with regard to management of requisitions, receipt and evaluation of offers, and preparation and administration of awards; performing detailed reviews of select contract files to ensure compliance with the FAR and the SEC's regulations and policies; and surveying and interviewing personnel from the eleven SEC regional offices to determine whether procurement activities are effectively managed.

Assessment of Interagency Acquisition Agreements

Government agencies use interagency agreements and acquisitions to take advantage of contracts, expertise and experience in other government agencies that they might not have internally. They can also use interagency agreements and acquisitions to provide services to other agencies. Interagency agreements provide government agencies with convenient access to commonly needed goods and services. Using these types of acquisitions can provide agencies with improved efficiency and convenience through a streamlined procurement process. However, interagency agreements must be effectively

managed. In 2005, the GAO designated the management of interagency contracting as a high-risk area. Also, a recent risk assessment survey of the SEC's contracting activities identified a number of potential risk areas that could affect the management of its interagency agreements.

We are performing an audit of the SEC's interagency agreements and acquisitions to assess whether the SEC obtains, manages, and closes interagency acquisitions in accordance with applicable requirements.

Evaluation of the SEC's Freedom of Information Act and Privacy Act Processes

The OIG has retained the services of a contractor to conduct an evaluation of the SEC's Freedom of Information Act (FOIA) processes and procedures. The FOIA generally provides that any person has a right of access to Federal agency records, with certain exceptions. Agency records that are not available to the public through reading

rooms may be made available in response to FOIA requests. Federal agencies are required to disclose their records, or portions of the records, upon receiving a written request, except when the records are protected from disclosure under one or more of the FOIA's nine exemptions. Agencies generally must respond to FOIA requests within 20 days and notify requesters of their right to appeal a response denying access to records.

The objective of the OIG's evaluation is to assess whether the FOIA/Privacy Act Office and other SEC divisions and offices follow applicable Commission and/or governing policies and procedures in responding to FOIA requests. Specifically, the contractor will assess whether the FOIA/Privacy Act Office appropriately follows applicable requirements, such as the FOIA, Executive Orders and governing Commission regulations, policies and procedures, in responding to FOIA requests. The contractor will also review the interaction among the various divisions and offices that oversee, process or respond to FOIA requests.



SEMIANNUAL REPORT TO CONGRESS

INVESTIGATIONS

OVERVIEW

The OIG's Office of Investigations responds to allegations of violations of statutes, rules and regulations, and other misconduct by SEC staff and contractors. The misconduct investigated ranges from criminal wrongdoing and fraud to violations of SEC rules and policies and the Government-wide standards of conduct. The OIG receives complaints through the OIG Hotline (which is both telephone and web-based), an office electronic mailbox and by mail, facsimile or telephone.

The most common way complaints were received during this reporting period was through the OIG Hotline, which was established in the past calendar year. Complaints may be made anonymously by calling the Hotline, which is staffed and answered 24 hours a day, 7 days a week. Complaints may also be made to the Hotline through an Online Complaint Form, which is accessible through the new OIG website that was launched during this semiannual reporting period. In addition to a mechanism for the receipt of complaints, the website also

provides the public with an overview of the work of the Office of Investigations, as well as investigative memoranda and other information pertinent to the work of the OIG as a whole.

The Office of Investigations conducts thorough and independent investigations into allegations received in accordance with the Quality Standards for Investigations of the CIGIE. In instances where it is determined that something less than a full investigation is appropriate, the Office of Investigations conducts a preliminary inquiry into the allegation. If the information obtained during the inquiry indicates that a full investigation is warranted, the Office of Investigations will commence an investigation of the allegation.

Upon the opening of an investigation, the primary OIG investigator assigned to the case prepares a comprehensive plan of investigation that describes the focus and scope of the investigation, as well as the specific investigative steps to be performed during the investigation. In all investigations, the OIG investigator interviews the complainant whenever feasible and conducts

significant interviews under oath and on the record. Where there is any reason to believe a witness will not provide truthful testimony, the OIG investigator provides an appropriate perjury warning. In addition, the OIG investigator gives assurances of confidentiality to potential witnesses who have expressed a reluctance to come forward.

Where allegations of criminal conduct are involved, the Office of Investigations notifies and works with the DOJ and the Federal Bureau of Investigation (FBI) as appropriate. The OIG also obtains necessary investigative assistance from the SEC's OIT, including the prompt retrieval of employee e-mail accounts as requested by the OIG investigators. The OIG investigative staff meets with the Inspector General frequently to review the progress of ongoing investigations. The OIG investigative unit also meets periodically with the Commission's Ethics Counsel to coordinate activities.

Upon completion of an investigation, the OIG investigator prepares a comprehensive report of investigation that sets forth in detail the evidence obtained during the investigation. Investigative matters are referred to the DOJ and SEC management as appropriate. In the investigative reports provided to SEC management, the OIG makes specific findings and recommendations, including whether the OIG believes disciplinary or other action should be taken. The OIG requests that management report back on the disciplinary action taken in response to an OIG investigative report within 45 days of the issuance of the report. The OIG follows up appropriately with management to determine the status of disciplinary action taken in the matter.

INVESTIGATIONS AND INQUIRIES CONDUCTED

Violations of Employee Securities Transactions Rules and Possible Insider Trading

On January 23, 2008, the OIG opened an investigation after the Ethics Office, in the SEC's OGC, informed the OIG that an Enforcement attorney frequently contacted that Office to obtain clearances to trade certain securities. This Enforcement employee's frequent contact with the Ethics Office raised suspicions that she may be engaged in day trading or insider trading and that she may have violated Rule 5 of the Commission's Conduct Regulation (Rule 5), which places certain restrictions on SEC employees' securities transactions.

After the OIG opened an investigation of this Enforcement attorney's securities trading, the OIG identified two other Enforcement attorneys who were friends with this Enforcement attorney and also traded in securities, and who often discussed securities transactions and open Enforcement investigations with one another during regular weekly lunches and via e-mail. After further investigation, we added one of these two Enforcement attorneys as an additional subject of the investigation.

The OIG completed a comprehensive review and analysis of more than two years of both Enforcement attorneys' e-mail records and obtained more than two years of their brokerage records. The OIG then compared these records with the reports they filed with the agency and the investigations on which they worked. We also took sworn, on-the-record testimony of the two subjects of the investigation, as well as six other Enforcement

attorneys, and conducted interviews of five other SEC employees.

The OIG investigation disclosed that approximately two months before an investigation of a large health care company was opened in her group, one of the subjects of the investigation sold all of her shares of stock in the company. We also found that she purchased additional shares of a global oil company's stock both a few days and a couple of weeks after a formal investigation of the company was opened by her friend who occupied the office next to her. She also sold shares of that company's stock two days before an inquiry was opened in the matter.

In addition, we found that both Enforcement attorneys who were subjects of the investigation traded in the stock of a large financial services company, even though their fellow Enforcement attorney became aware of three separate Enforcement investigations of that company. This fellow Enforcement attorney credibly testified that she told both subjects during their regular weekly lunches that she could not purchase additional stock in this company because she had become aware of these investigations. Yet, the investigation found that both subjects traded in the stock of this particular company.

We also found that all three Enforcement attorneys committed violations of different aspects of the securities reporting requirements of Rule 5.

The investigation further revealed that although the SEC, through its law enforcement function, is charged with prosecuting cases of violations of the securities laws, including insider trading on the part of individuals and companies in the private sector, the agency has essentially no compliance system in place to ensure that

SEC employees, with tremendous amounts of non-public information at their disposal, do not engage in insider trading themselves. The current disclosure requirements and compliance system are based on the honor system, and there is no way to determine if an employee fails to report a securities transaction. Further, no spot checks are conducted and the SEC does not obtain duplicate brokerage account statements. In addition, there is little to no oversight or checking of the securities transaction reports that employees file to determine their accuracy or even whether an employee has reported at all. Moreover, the various types of reporting forms are submitted to different SEC offices, which do not routinely share that information with each other.

In addition, the OIG concluded that there is a poor understanding and lax enforcement of the financial disclosure reporting requirements. For example, both Enforcement attorneys who were the subject of the investigation testified that no one had ever questioned their reported securities holdings or transactions in the decades they worked at the SEC and traded securities. Moreover, both managers who are responsible for reviewing the subjects' annual Office of Government Ethics (OGE) Form 450s testified that they do not recall ever questioning any SEC employee relative to their reported securities holdings. In addition, we found that the Enforcement attorneys and supervisors who provided information during our investigation lacked a basic understanding of the requirements in place that govern the reporting of stock transactions by SEC employees.

The OIG investigation also found that Enforcement personnel, both managers and staff, have different interpretations of the confidentiality policy pertaining to

Enforcement investigations and whether they can discuss their investigative matters with one another. Additionally, we found that the two Enforcement attorneys who were subjects of the investigation routinely discussed stocks and investment strategies in e-mails sent from their SEC e-mail accounts and in public locations.

Further, our investigation found that the two Enforcement attorneys who were subjects of the investigation maintained separate folders entitled, “Stocks,” in their SEC e-mail accounts, and, on most days, sent e-mails from their SEC e-mail accounts about stocks and their own stock transactions. We discovered that one of the two subjects traded often and testified that the financial markets were her main hobby and passion. We found that she spent much of her work day e-mailing and searching the Internet about stocks. The OIG also found that the subjects shared many of the same investments and had regular lunch meetings where they often discussed the stock market and their own securities transactions, as well as their SEC work and investigative cases.

The OIG investigation disclosed that one of the two subjects of the investigation sent e-mails to his brother and sister-in-law from his SEC e-mail account during the work day recommending particular stocks, and sometimes informed them that the other subject of the investigation had recommended those stocks as well. Both these Enforcement attorneys inexplicably testified that they failed to see how sending e-mails to family members from an SEC e-mail account could raise an appearance that the Enforcement attorney may be sharing non-public information with someone outside the SEC.

The OIG issued its report of investigation to management on March 3, 2009, and recommended that appropriate disciplinary

action be taken against the two Enforcement attorneys who were the subjects of the investigation. In its report of investigation, the OIG also provided the Commission with 11 specific recommendations to ensure adequate monitoring of employees’ stock transactions. These recommendations included: establishing one primary office to monitor employees’ securities transactions; instituting an integrated, computerized system for tracking and reporting purposes; obtaining duplicate copies of brokerage record confirmations for each securities transaction for every SEC employee; requiring employees to certify in writing that they do not have non-public information related to each security transaction they conduct and report; conducting regular and thorough spot checks for compliance purposes; and establishing comprehensive and more frequent training on all aspects of Rule 5 and its requirements.

We understand that the Commission’s Ethics Office is working to establish a compliance office that would use an automated web-based tracking system, which we believe is critical and long overdue. We encouraged the Ethics Office to incorporate all of our recommendations into this new system and to consult with us as appropriate to ensure that a comprehensive Rule 5 compliance system is put into place.

Because of the serious nature of the information uncovered during the OIG investigation, we also referred the matter to the United States Attorney’s Office for the District of Columbia’s Fraud and Public Corruption Section, which, together with the FBI, is conducting an investigation of possible criminal and civil violations. The OIG is coordinating with the United States Attorney’s Office in connection with the ongoing investigation.

No action had been taken by SEC management as of the end of the reporting period as a result of the OIG's investigation. SEC Chairman Mary L. Schapiro was sworn in on January 27, 2009. We hope that actions to address our findings and recommendations will be taken expeditiously.

Violation of Security Officers Rules, Improper Issuance of Waiver from Contractual Requirements and Other Inappropriate Conduct Involving Commission Security Operations

The OIG commenced an investigation on July 2, 2008, as a result of information contained in an anonymous complaint letter to former SEC Chairman Christopher Cox, involving multiple allegations against an individual working for a company that was contracted to provide security services for the SEC. The complaint alleged that the contractor, who supervised all security guards contracted to work at the SEC, was arrested on multiple occasions for drunk driving, appeared drunk during his duty hours, and harassed female employees.

The OIG interviewed and/or took sworn testimony of two SEC employees who oversaw the security services contract, five SEC security guards including the subject of the investigation, the Managing Director of the security services company, and two representatives of the District of Columbia (D.C.) Metropolitan Police Department Security Officers Management Branch. The OIG also obtained and analyzed a report from the Capitol Police and a memorandum from the Metropolitan Police Department regarding an arrest of the subject. Additionally, we requested and reviewed e-mails provided by OIT for the periods from December 2005 through June 2006 and

January 2007 through November 2007 for several employees and contractors.

The OIG investigation did not find evidence that the security guard contractor had harassed female employees, or been drunk during his duty hours at the SEC. However, the OIG did find evidence that the security guard contractor was arrested and pled guilty to driving while intoxicated (DWI) during the time he was serving as a Special Police Officer at the SEC. The OIG received a copy of the arrest report from the United States Capitol Police, which confirmed that the security guard contractor's vehicle was stopped and that he failed a field sobriety test. The investigation found that the security guard contractor consented to a breathalyzer test that evidenced a blood alcohol level of 0.10 and 0.09, both of which are above the legal limit.

Special Police Officers (SPOs), such as the security guards at the SEC are privately-commissioned police officers with full arrest powers within an area or premises that the officers have been employed to protect. The D.C. Metropolitan Police Department Security Officers Management Branch (SOMB) oversees the private security industry that operates within D.C. Pursuant to the SOMB Policy Manual, the contractor was required to report his arrest to the SOMB within 24 hours of the arrest. The investigation found, however, that the contractor returned to his position at the SEC the day after he was arrested without notifying the SOMB or his employer, the security company that contracted with the SEC.

The OIG investigation also found that ten months after his arrest, the contractor went to the SOMB to renew his SPO commission. As part of the renewal procedure, the SOMB

conducted a criminal background search and uncovered the earlier DWI arrest. The SOMB immediately revoked the contractor's SPO police powers, conducted a preliminary investigation into the matter, and verified that the contractor was arrested for the DWI charge referenced above. The SOMB issued a report of its investigation to the contractor, concluding that he was in violation of the SOMB policy manual and revoking his SPO powers.

On the date the SOMB discovered the security guard contractor's arrest, the SOMB informed the security company that the security guard contractor's SPO commission had been revoked. The security company, in turn, notified the project manager for the company's security services contract with the SEC, and an SEC employee. This SEC employee claimed he was the Contracting Officer Technical Representative (COTR) for the security services contract (although there is no evidence that he actually ever received a COTR appointment letter), and that he was informed that the security guard contractor could no longer perform his duties at the SEC because the SOMB had revoked his SPO commission and license to carry a firearm.

As a result of the above-described information, the SEC employee unilaterally issued the security guard contractor a waiver to continue working as the Acting SEC Project Manager for the security company. The SEC employee testified that he made the decision that the security guard contractor could remain in his duties, even though he could not lawfully carry a firearm anymore, because there was no specific requirement that the security guard contractor or the project manager have an SPO commission.

The security guard contractor admitted under oath that he had been arrested for

DWI, but claimed he had disclosed that information to the SOMB. However, the OIG's investigation determined that in fact, the security guard contractor never reported his DWI arrest to the SOMB or his employer.

In addition, the OIG investigation concluded that had the security guard contractor informed the SOMB of his arrest as required, his SPO commission would have been revoked in January 2007. Because the security guard contractor failed to notify the SOMB, he inappropriately continued to act as an SPO at the SEC for approximately ten months, during which time he continuously carried a firearm in direct contravention of SOMB policy.

The OIG investigation also found that the SEC employee who claimed to be the COTR on the contract improperly issued the security guard contractor the waiver to continue to supervise the security guards, as he had no authority to amend the contract with the security company and, in fact, had never even been officially appointed as a COTR. Finally, the OIG investigation found evidence that both the security guard contractor and the SEC employee violated the Agency's policies on use of SEC office equipment.

On December 15, 2008, the OIG issued its report of investigation in this matter to management, recommending appropriate action, up to and including removal from the contract, against the security guard contractor, and disciplinary action for the SEC employee. The security company removed the security guard contractor from the contract the day the OIG report of investigation was issued. In addition, the SEC employee has been removed from the contract and was issued a written reprimand.

Financial Analyst's Chronic Leave Abuse and History of Non-Compliance with Management Directives

The OIG opened an investigation on June 5, 2008, into an allegation that an SK-12 Financial Analyst in the Division of Investment Management was abusing leave by arriving late to work without obtaining supervisory approval. Additionally, it was alleged that the employee was remaining in the workplace until late at night and using SEC equipment and resources for matters unrelated to his official duties.

The OIG obtained and reviewed the Financial Analyst's Official Personnel Folder and conduct folder. In addition, for the period from April 1, 2008 to July 14, 2008, we obtained and analyzed his Requests for Leave or Approved Absence forms (OPM Form 71), the building access history records that documented his daily entries and exits from the building, the SEC Employee Blue Temporary ID Badge Log for June 12, 2008, his SEC computer Internet user history logs, his time and attendance records, his leave and earnings statements, his e-mail traffic and documents saved to his SEC computer hard drive.

We also took sworn, on-the-record testimony of the subject's two supervisors and the Branch Chief of the Commission's Work/Life and Disabilities Program. The OIG made numerous attempts over an extended period of time to take the subject's testimony, but he refused to speak to the OIG investigator.

The OIG investigation revealed that the subject's history of non-compliance with management directives and unexcused tardiness dated back to 1999. In 1999, the

subject was given an official reprimand for failure to complete work assignments in a timely manner and for unexcused tardiness. In 2000, he was suspended from duty and pay status for five workdays for his failures to: (1) complete work assignments in a timely fashion; (2) comply with management's directive that he report to his supervisor's office at a minimum of each Tuesday and Thursday at 5:00 p.m. to discuss the status of his work assignments; (3) comply with management's directive that he leave the workplace each workday by 6:00 p.m.; (4) comply with leave restriction requirements issued by management; and (5) seek his supervisor's advance approval for his absences.

Because of the nature of the allegations regarding the subject's leave abuse and his history of non-compliance with management directives, the OIG analyzed in great detail the subject's daily entries and exits from the workplace and his requests for leave for the period from April 1, 2008 through July 14, 2008. The OIG investigation revealed that during that entire three and one-half month period examined, the subject had not once arrived to work on time. In fact, the subject arrived to work late and/or left work early without taking approved leave for a total of 112.67 hours during this time period.

The investigation further revealed on a number of occasions, the subject's supervisors became aware of the late arrivals and demanded that he submit a leave slip for the time he was absent. However, the investigation revealed that management was completely unaware of the magnitude of the subject's absences during this period.

Our review of the evidence obtained during the investigation also confirmed that

on numerous occasions, the subject remained in the workplace well beyond the end of his scheduled workday, at times until 11:00 p.m. and, on one occasion, until 2:49 a.m. The subject employee was not given permission to decide unilaterally to come to work late and then make up those hours by staying past the close of his regular workday, and there was no business purpose for him to remain in the workplace late at night.

On November 10, 2008, the OIG referred the allegations and factual findings of the investigation to the United States Attorney's Office for D.C. for its consideration of a possible criminal prosecution. On November 12, 2008, the United States Attorney's Office issued a written declination of prosecution.

On March 18, 2009, the OIG issued its report of investigation to management, finding that the subject violated SEC policies and procedures by being absent without leave from the workplace on numerous occasions. In view of the fact that this was the subject's third offense, and in light of the significant number of hours he was absent from the workplace, the OIG recommended that management take disciplinary action, up to and including dismissal. We also recommended that management consider charging the subject for the hours of his unauthorized absences from duty for which he failed to request leave, as outlined in the OIG report. As of the end of the semiannual reporting period, management had not taken any disciplinary action.

Lack of Impartiality by Assistant Director in Performance of Official Duties

The OIG opened this investigation on August 7, 2008, into an allegation that an OIT SK-17 Assistant Director supervised a

subordinate employee with whom he was having a romantic relationship. The complainant further alleged that the Assistant Director may have directly or indirectly been involved in the subordinate's promotion to the position of SK-14 IT Specialist from SK-13 Program Analyst. The complainant also alleged that the Assistant Director stripped him of his supervisory responsibilities after he informed the Assistant Director's supervisor of the improper relationship.

In conducting its investigation, the OIG obtained and reviewed Official Personnel and conduct folders and e-mails for the Assistant Director and the woman with whom he was allegedly having a romantic relationship. We also took sworn, on-the-record testimony of 12 current and former SEC personnel, including the complainant, the Assistant Director, the woman with whom he was allegedly having a romantic relationship, and numerous co-workers and supervisors.

The OIG investigation did not substantiate the allegation that the Assistant Director was engaged in a romantic relationship with the subordinate while he was supervising her. Rather, the investigation uncovered no evidence of a romantic relationship until at least four months after the effective date of the subordinate's promotion, and the Assistant Director's supervision of the subordinate terminated upon her promotion. Moreover, the investigation found that the Assistant Director had no direct role in the subordinate's promotion, although he was asked by the selecting official and her new supervisor about her performance during the hiring process, and informed the hiring officials that her performance was adequate and satisfactory.

During the course of our investigation, however, we uncovered other evidence

demonstrating that the Assistant Director engaged in improper behavior under SEC policies and rules and the Standards of Ethical Conduct for Employees of the Executive Branch. Specifically, for the years 2005 and 2006, while he was romantically involved with the subordinate, the Assistant Director served on OIT's Compensation Committee. As one of the three members of that Committee, he evaluated merit pay increase recommendations for over 100 OIT employees – including the employee with whom he had a romantic relationship – and presented merit pay determinations to his supervisor. In addition, this Assistant Director served as OIT's Ethics Liaison.

The investigation found that the Assistant Director only recused himself from merit pay deliberations involving the employee after the relationship became public and thus participated in her merit pay decisions for two years in which they were romantically involved.

On March 5, 2009, the OIG issued its report of investigation to management. The OIG's report found that although the Assistant Director did not modify the merit pay recommendations for the employee with whom he had a romantic relationship, he failed to take appropriate steps to avoid the appearance of a loss of impartiality in the performance of his official duties and used his position as a member of the Compensation Committee to endorse the employee. The evidence obtained in the investigation further revealed that the Assistant Director, despite being an Ethics liaison, never sought guidance from the SEC's Ethics Office about whether he was permitted to participate in deliberations involving the employee's merit pay increases while he served on OIT's

Compensation Committee. Therefore, we referred this matter to management for appropriate disciplinary action against the Assistant Director, and for consideration of removing him from his position as OIT Ethics Liaison.

As of the end of the semiannual reporting period, management had not taken any disciplinary action.

False Statement Allegations and Finding of Lack of Candor in Interview with OIG Investigator

On December 27, 2007, the OIG opened an investigation into a complaint from a former Enforcement attorney, alleging two separate violations of 18 U.S.C. § 1001 regarding statements made by SEC staff as to what documents he was provided when he requested his employee personnel file after his termination in September 2005. First, the complainant alleged that an Enforcement Program Support Specialist made false statements in an October 2005 e-mail she sent discussing a meeting she had with him to provide him with his file. Second, he claimed that an Enforcement Administrative Contact made a false statement to an OIG investigator during the course of a previous OIG investigation regarding what personnel documents were provided to the complainant and whether copies were maintained.

The previous OIG investigation referred to in the complaint investigated this period arose out of a September 2, 2005 complaint addressed to former SEC Chairman Christopher Cox. In that earlier complaint, the former Enforcement attorney claimed, inter alia, that his supervisors in Enforcement

gave preferential treatment to the Chairman and Chief Executive Officer of a large investment bank, whom the complainant was pursuing as a potential tipper in an insider trading investigation of a hedge fund.

In the investigation conducted during this reporting period, the Inspector General took the sworn, on-the-record testimony of the complainant, as well as eight current SEC employees and one former SEC employee. We also obtained and reviewed e-mails for seven current SEC employees for the 2005-2006 timeframe and conducted substantial analysis of the e-mails and other relevant documentation.

The OIG issued a report of investigation to management on March 17, 2009. The OIG investigation found as follows regarding the former Enforcement employee's false statement claims. On September 19, 2005, shortly after his termination from the SEC, the complainant sought to review all of his SEC personnel files. SEC employees have two sets of personnel files or folders: an Official Personnel Folder (OPF) that is maintained by the Office of Human Resources, and an Employee Performance File (EPF) which is maintained in the division or office in which an employee works. On September 20, 2005, the complainant initially received a copy of his OPF from an SEC Human Resources Specialist, which included standard employment documents, the complainant's offer letter and insurance documentation. When the complainant advised Commission personnel officials that he was really searching for his evaluations because they were relevant to an ongoing EEO case he had against the SEC, he was informed that these documents were maintained in his EPF. The complainant then contacted the Enforcement Program Support Specialist and arranged a meeting with her for September 22, 2005, to review his

EPF. The investigation found that the Program Support Specialist gave the complainant certain documents from his EPF, including documents related to his hiring such as his initial job application and personnel actions, but did not provide him with the performance evaluations he was seeking. The investigation disclosed no evidence that the Program Support Specialist gave the complainant any original documents.

The Program Support Specialist memorialized what occurred during her meeting with the complainant in an October 5, 2005 e-mail, in which she stated, in pertinent part: ". . . [Complainant] called me to request that I meet him in the lobby at Station Place to give him his EPF folder that was kept in the Division of Enforcement. The contents of the folder included his initial job application and the personnel actions. . . . The performance rating was not included because it had not been returned to the Administrative Office due to the recent processing."

After the complainant realized that he had not received the evaluations he had sought, on September 27, 2005, the complainant, with the assistance of the SEC employee union, made additional requests for his the evaluations he had not obtained. In October 2005, the complainant finally received several of the evaluations he was seeking.

On December 30, 2005, the complainant sent a FOIA request to the SEC, seeking, inter alia, all of his employee performance and personnel files and documents relating to his evaluations or performance. He also made a request for his personnel file to the Federal Records Center, which informed him it did not have any of the documents he was requesting.

On April 11, 2006, the complainant sent a letter to a Human Resources Specialist, the Enforcement Administrative Contact and a Research Specialist in the SEC's FOIA Office, requesting that he be provided with the current location of his EPF. The FOIA Specialist responded to the complainant on April 24, 2006, enclosing a copy of a performance plan and evaluation form that had not previously been provided to him. She also stated: "With regard to your EPF file, Commission staff has advised that you have been provided with the original EPF file, and that the Division of Enforcement does not maintain a copy, nor does any other Commission office."

The complainant maintained that the FOIA Specialist's representation in her April 24, 2006 letter was inaccurate because he had not been given any original documents and copies were maintained of the documentation provided him. However, he did not claim that the FOIA Specialist had violated any false statement statutes, as he maintained that she had relied on statements made by the Enforcement Administrative Contact in sending the letter.

The complainant did claim that the Program Support Specialist's October 5, 2005 e-mail that described the complainant's request for his original EPF folder and described the contents of the EPF folder given to him, violated 18 U.S.C. § 1001, since she did not actually give him his original EPF folder. Nowhere in this October 5, 2005 e-mail, however, did the Program Support Specialist explicitly state that she gave the complainant his entire original file or even any original documents. Accordingly, the OIG investigation found that the complainant's claim that the Program Support Specialist violated 18 U.S.C. § 1001, or otherwise lacked

candor in drafting her October 5, 2005 e-mail, was not substantiated.

The complainant also claimed that the Enforcement Administrative Contact violated 18 U.S.C. § 1001, when he stated to an OIG Investigator in an interview conducted as part of an official OIG investigation, in referring to the meeting between the Program Support Specialist and the complainant, that they had given the complainant "everything in person, don't keep anything." The OIG investigation did not find sufficient evidence that the Enforcement Administrative Contact had the specific intent to make a false statement or that he knew his statement was incorrect and nevertheless deliberately misrepresented the facts. Thus, the OIG investigation did not find that there was sufficient evidence to support a charge against the Enforcement Administrative Contact for violation of 18 U.S.C. § 1001 or an administrative charge of falsification.

Nonetheless, the OIG investigation did conclude that the Enforcement Administrative Contact lacked candor in his communications with the OIG investigator. Specifically, we found that his statement to her that the complainant was given everything by the Program Support Specialist and nothing was kept was misleading, as the Enforcement Administrative Contact knew the complainant was not given everything and believed that copies of the documents given to the complainant may have been kept. When shown the OIG investigator's notes of the Enforcement Administrative Contact's conversation with her that reflected that the statement described above, the Enforcement Administrative Contact acknowledged that the OIG investigator's notes were an accurate reflection of the conversation he had with her. He also admitted that the Program Support Specialist had not given the complainant all

the documents that should have been in his EPF. The Enforcement Administrative Contact further admitted that he did not know if the complainant actually got any original documents and that he assumed the OGC had actually kept copies of everything that was sent to the complainant. Thus, the OIG investigation found that the Enforcement Administrative Contact's statement to the OIG investigator failed to disclose relevant information concerning what the Program Support Specialist actually had provided to the complainant and what was retained by the SEC that, in the circumstances, should have been disclosed in order to make his statements accurate and complete.

In light of the foregoing, we concluded that the Enforcement Administrative Contact's statement to the OIG investigator during an interview in an official OIG investigation was not a full and truthful description of what occurred with the complainant's EPF and lacked forthrightness. Accordingly, we referred the Enforcement Administrative Contact's lack of candor to management for appropriate disciplinary action. The OIG investigation also concluded that there was a great deal of confusion within the agency regarding what happens to an EPF after an employee is separated from the SEC. We also found that the SEC's manual provisions regarding the maintaining of employees' personnel folders are considered by some SEC personnel officials to be obsolete and are not being followed. Accordingly, the OIG also referred the report to the OHR for review of the Commission's policies and procedures concerning EPFs to ensure that these files are properly protected and produced upon request.

No action had been taken on the OIG's referral for disciplinary action and recommendation for review of policies and procedures as of the end of the reporting period.

Unauthorized Disclosure of Non-Public Information by SEC Staff Attorney

On October 17, 2008, OIG opened an investigation as a result of information received from an informant who was also a former employee of a large investment bank. In his complaint to the OIG, the informant alleged that an individual on the SEC's New York Regional Office (NYRO) staff disclosed non-public information about the informant's contacts with the SEC to counsel representing the investment bank, which then used that information against him in a whistleblower retaliation complaint he had filed against the company.

The OIG took the sworn testimony of the informant, the subject of the investigation and the subject's supervisor. In addition, the OIG conducted interviews of several witnesses outside of the Commission who had relevant information concerning the allegations.

The investigation revealed that in June 2004, while he was still employed with the investment bank, the informant became concerned that the investment bank was not fully cooperating with an ongoing SEC investigation into its market timing activities. The informant then contacted SEC NYRO staff and offered to provide to the SEC e-mails that he believed were relevant to the SEC's investigation. In doing so, the informant initially requested a bounty from

the SEC, but was told that, in this case, any information he would provide would not be eligible for a bounty. Nevertheless, the informant turned over copies of the investment bank's e-mails to NYRO staff. The informant was subsequently terminated by the investment bank, and he filed a whistleblower retaliation complaint with the Department of Labor (DOL) under the provisions of the Sarbanes-Oxley Act.

After interviewing NYRO staff, as well as outside counsel for the investment bank and the DOL staff, the OIG was able to confirm the identity of the SEC staff member who revealed to counsel for the investment bank that the informant had requested a bounty from the SEC. Further, the investigation found that the SEC staff member not only gave permission to, but actively encouraged, counsel for the investment bank to divulge this information to the DOL as evidence against the informant in the whistleblower retaliation proceeding.

The OIG issued its report of investigation on March 30, 2009, finding that, contrary to SEC regulations, the NYRO staff attorney was responsible for disclosing non-public information about the informant's request for a bounty from the SEC to the investment bank's outside counsel. We referred the matter to management for consideration of disciplinary action and requested to be advised of any action taken by management in response to the OIG report within 45 days.

Allegation of Retaliation by Managers in the Los Angeles Regional Office

On April 16, 2008, the OIG opened an investigation into allegations made by a grade

SK-14 Staff Attorney in the Los Angeles Regional Office (LARO) concerning misconduct, retaliation and perjured testimony arising out of a 2003 OIG investigation of this Staff Attorney's conduct. The Staff Attorney alleged that LARO managers who served on the Compensation Committee for the 2007 rating period retaliated against him by awarding him only a one-step merit pay increase because he had been (1) the subject of the 2003 OIG investigation; and/or (2) a whistleblower by providing information to the Senate Finance Committee and Judiciary Committee investigative attorneys in connection with their investigation of the firing of a former SEC Enforcement attorney. The complainant also alleged that LARO managers provided perjured testimony in the 2003 OIG investigation; that LARO managers had engaged in conduct similar to that which he was found to have engaged in, but were not disciplined in the same manner; and that a certain LARO manager heard that he had spread rumors about her and failed to give him a copy of the 2003 OIG report of investigation in a timely manner because she was biased against him.

The complainant further alleged that the SEC's former Inspector General and the Counsel to the Inspector General engaged in misconduct when conducting the October 2003 OIG investigation. The SEC OIG referred this allegation to the National Science Foundation (NSF) OIG to avoid any conflict of interest that might arise in investigating allegations against SEC OIG staff. The NSF OIG conducted an investigation of the allegations against the SEC OIG staff and, in a letter dated August 22, 2008, found no evidence to support the allegations.

In its investigation of the allegations against the LARO managers, the OIG took sworn, on-the-record testimony of the complainant, as well as five senior-level LARO officials. The OIG also interviewed the complainant's Branch Chief, and an Assistant Regional Director.

The OIG thoroughly investigated the staff attorney's allegations of retaliation and found them not to be substantiated. The OIG investigation did find that while the Staff Attorney's direct supervisor recommended him for a two-step merit increase for the 2007 rating period, the Compensation Committee only awarded him a one-step increase. This was determined to be due, however, to SEC-wide budgetary constraints. Specifically, of the 110 employees in the LARO, 17 received zero steps, 55 received one step, 34 received two steps, and only four received three steps. The Staff Attorney was found to have received the same number or more steps than the majority of the LARO staff.

The OIG investigation also found that there was no evidence that LARO managers were aware that the Staff Attorney had communicated with Senate investigators in an investigation. The Staff Attorney claimed that his name appeared in a link from a *New York Times* article to the Senate investigation report, and that the LARO managers on the Compensation Committee who were responsible for determining the merit pay increases for staff knew that he had been in contact with the Senate Finance Committee.

In the OIG investigation, the managers credibly testified under oath that they had no knowledge of the Staff Attorney having any contact with the Senate investigators, nor did they know that his name had appeared in the Senate investigation report link in the *New York Times* article. The OIG investigation found

that the Staff Attorney's name was removed from the Senate Report after several days. Moreover, the Staff Attorney presented no proof, nor could the OIG find any evidence during the course of the investigation, that any of the managers who made decisions concerning his compensation saw his name in the Senate report or knew that he was in contact with any Senate Committee.

The OIG investigation also found no evidence that certain LARO managers perjured themselves during the 2003 OIG investigation. In the 2003 OIG investigation, the OIG found that the Staff Attorney had engaged in abusive and intimidating conduct toward several LARO staff members and recommended that a copy of the report be sent to management for administrative action as appropriate. We further found that although two of the staff members had also made certain derogatory remarks, including negative comments about a LARO manager, the evidence showed that their conduct was less egregious than the Staff Attorney complainant's conduct and that they were counseled for their actions.

The OIG also found that while there was evidence of a perception in the office that the Staff Attorney may have been the source of rumors concerning certain managers, there was no concrete evidence of a connection between these rumors and any manager's role on the Compensation Committee. We also did not find any merit to the allegation that anyone improperly delayed giving the staff attorney a copy of the 2003 OIG report.

On March 16, 2009, the OIG issued a report finding the complainant's claims to be unsubstantiated. The OIG did recommend, however, that given the repeated concerns that the Staff Attorney has expressed about managers' lack of partiality, certain LARO

managers should recuse themselves from any future decisions pertaining to the Staff Attorney's performance and/or affecting his compensation, pay or benefits. As of the end of the semiannual reporting period, the agency had taken no action on the recommendation.

Allegations of Perjury by a Regional Office Official and Receiver Conflict of Interest

On April 16, 2008, OIG opened an investigation into allegations by shareholders of a particular company that the SEC's Denver Regional Office (DRO) engaged in misconduct in their investigation and prosecution of a civil action against the company. Specifically, the complaint alleged that: (1) the then-DRO Regional Director perjured himself in a letter to Senator Bill Nelson about the investigation into the company; (2) DRO Enforcement attorneys committed perjury to the Court in which the action against the company was brought by objecting to the company's late request for a jury trial after allegedly agreeing that the company was entitled to a jury trial; (3) the Court-appointed receiver had a conflict of interest; and (4) the SEC's lawsuit against the company was filed in retaliation for its filing suit against the SEC.

During the course of its investigation, the OIG obtained and reviewed hundreds of e-mails and documents submitted by an organized group of the company's shareholders, as well as other individuals related to the company. In addition, we took on-the-record testimony and interviewed by telephone current DRO and headquarters employees. We also interviewed by telephone

several of the shareholders and interested parties.

We thoroughly investigated the allegation that the former DRO Regional Director made perjurious statements in a letter to Senator Nelson in response to the Senator's previous letter of November 9, 2007. In the Regional Director's letter, he outlined the SEC's actions against the company, and further stated that the company had failed to produce any evidence to support the claims of naked short selling of its stock. During the OIG investigation, the former DRO Regional Director acknowledged an overstatement in the third to last paragraph of his letter, which indicated the stock "sold short," when the proper terminology was "failures to deliver." We conducted a comprehensive review of the letter and confirmed that the information contained in the letter that was alleged to be perjurious was, in fact, accurate. We also reviewed the remainder of the letter and found that no statements in the letter were perjurious or misleading.

The OIG investigation also found that, contrary to the allegations, the SEC could not have promised defendants a jury trial, as the Federal Rules of Civil Procedure require defendants to request a jury trial in a timely manner. The OIG investigation found that the Court's granting of summary judgment to the SEC precluded any need for a jury trial, regardless of whether the company had properly requested one or not (which they admit they did not). We also found the SEC did not agree to a jury trial, nor was there evidence the DRO attorneys were trying to hide their agreement from the judge. Moreover, the judge issued a ruling denying the defendant's request for a jury trial as moot, but did so without prejudice (thus allowing the company an opportunity to

amend its answer and request a jury trial if the company prevailed on appeal).

The concerned shareholders also alleged problems with the appointment of the Court-appointed receiver, specifically claiming that the Court did not hold a hearing about her appointment and that she was not required to post a bond. The OIG found that the SEC moved for appointment of a receiver, and the Court granted this motion. The Court then appointed a receiver, and she issued her first report to the Court. According to the Court's docket sheet, none of the shareholders objected to the receiver's appointment. While the OIG found no conflict of interest, the OIG looked further to determine whether the DRO followed proper procedures in recommending the receiver. The OIG investigation revealed that the DRO followed the SEC's internal procedures regarding the recommendation of the receiver in this matter. Moreover, it was the Court that, upon due consideration of potential candidates, selected and appointed the receiver.

As noted above, the concerned shareholders alleged that the SEC's lawsuit against the company was filed in retaliation for its filing suit against the SEC. However, the OIG investigation found that the DRO began its investigation into the company well before the company filed its suit against the SEC. While the OIG investigation revealed that the timing of the SEC's filing its complaint against the company just a few weeks after it filed suit against the SEC appeared suspicious, the evidence showed that the SEC investigation of the company was already well under way by the time the company sued the SEC. Moreover, the OIG could find no concrete evidence that retaliation was a motive in the SEC's filing of

its complaint, nor any evidence that subpoenas were issued for the purpose of harassment.

Misuse of Resources and Official Time for Outside Businesses

During this semiannual reporting period, the OIG completed an investigation and several inquiries into whether employees in several SEC offices misused government resources and official time to support private photography or videography businesses. The matter investigated arose out of investigations conducted during previous semiannual reporting periods that found evidence that three other SEC employees had used substantial government resources and time for private photography businesses. The inquiries we completed were a result of information uncovered during OIG investigations conducted during the current and prior semiannual reporting periods.

In the matter investigated during this semiannual reporting period, which was opened on April 28, 2008, the OIG investigation uncovered abundant evidence that the subject employee, an SK-13 Information Technology Specialist who had been with the SEC for 18 years, repeatedly used SEC resources and official time in support of his private photography business. The investigation found that the employee operated a lucrative for-profit photography business, providing wedding and portrait photography services for approximately six years. He also identified three other SEC employees who work with him in his business.

The investigation further uncovered evidence that the employee conducted his

private business at work during official business hours, and used SEC resources for this purpose, including using his work computer for receiving and sending e-mails and reviewing documents, photocopiers, printers, fax machines, and telephones.

Much of the evidence concerning the employee's misuse of resources and time came from his own admissions on the record during sworn testimony. The employee also admitted that he knew it was against SEC policy to use SEC resources and office equipment for commercial purposes, and acknowledged making mistakes and tremendous errors in judgment.

In addition to taking the employee's sworn, on-the-record testimony on May 21, 2008, the OIG obtained and reviewed the employee's e-mails for the period from May 2007 through April 2008 (excluding one month that was not available from OIT) and found numerous non-work related images. The OIG also reviewed the employee's Official Personnel Folder and conduct file, which revealed no prior disciplinary actions. The OIG examination of his time and attendance records for the time period from December 2007 through May 2008 did not reflect any unusual absences from work. Finally, the OIG interviewed the employee's supervisor.

On November 7, 2008, the OIG issued its report of investigation, setting forth in detail the evidence uncovered during the investigation and recommending disciplinary action against the employee. As of the end of the semiannual reporting period, management had taken no action.

In addition, the OIG completed six inquiries into complaints that employees in

various SEC offices were misusing SEC resources and time by conducting private business activities during working hours. Five of the six employees were alleged to have photography businesses, while one employee allegedly had a videography business. During these inquiries, the OIG obtained from OIT the e-mails of each of the employees for a four-month period. OIG staff conducted a thorough review of the employee's inbox and sent messages folders, searching for evidence of any significant misuse of SEC resources and time for a private business. The OIG also requested that OIT staff examine the employees' computer hard drives for evidence of misuse of government resources for a private business. OIT examined the hard drives of computers used by four of the six employees; the computers of the remaining two employees were unavailable for examination. For all six employees, the e-mail and hard drive reviews conducted revealed no significant evidence that these individuals were using SEC resources and time to conduct private businesses.

Misuse of Computer Resources and Official Time to View Pornography

During this semiannual reporting period, the OIG continued to receive from the OIT Information Security Group lists of SEC employees or contractors who had numerous attempts to access pornographic websites from SEC computers that were blocked by the agency's internet filter, as well as instances where they successfully accessed pornography or inappropriate material. Depending on the frequency of the accesses and attempted accesses and the nature of the material access, the OIG conducted a full investigation or a more limited inquiry as discussed below.

Beginning on October 20, 2008, the OIG conducted an investigation into information showing a Los Angeles Regional Office SK-17 supervisor had been using his SEC-assigned computer to access Internet pornography. The investigation revealed that while using his SEC computer during 17 working days, the employee received approximately 1,880 access denials for Internet websites classified by the SEC's Internet filter as pornography. The images on these websites included graphic depictions of sexual acts.

The supervisor admitted under oath that he accessed and attempted to access these pornographic and sexually-explicit websites up to twice a day from his SEC computer during work hours. The supervisor also admitted that he saved numerous pornographic and sexually-explicit images to his SEC computer hard drive and that he viewed those saved images during work hours. In addition, he admitted that he had personal accounts with pornographic websites and that he accessed pornography from his SEC computer while on travel. The supervisor also acknowledged that his searching for and viewing pornographic images may have interfered with his SEC work. The supervisor was reprimanded.

The OIG also conducted inquiries during the reporting period into the misuse of SEC computer resources to view pornography by one SEC employee and three Enforcement contractor personnel. In the matter involving the SEC employee, the evidence showed that this individual received 52 access request denials for Internet websites classified by the Internet filter as pornography in a ten-day period. Many of these denials occurred during normal SEC work hours. Information provided by OIT also revealed additional instances in which the employee successfully

accessed sexually-suggestive websites. The OIG issued a memorandum report on December 12, 2008, and referred the matter for disciplinary action. Based on the OIG's report, the employee was issued a memorandum of warning to counsel him regarding his misuse of SEC computer resources and official time.

In the three matters involving Enforcement contractor personnel, the information provided by OIT demonstrated that each of these individuals received hundreds of access request denials for websites classified by the Internet filter as pornography during periods ranging from approximately four to seven weeks. Moreover, a review of the information provided by OIT revealed additional instances in which each of these contractors successfully accessed sexually explicit and suggestive Internet websites that contained nudity and portrayals of sexual acts. The OIG issued memoranda reports on December 12, 2008, in all three matters. In response to the OIG's reports, the employment of the three contractors was terminated.

Other Inquiries Conducted

During this semiannual reporting period, the OIG also completed inquiries into other numerous matters brought to its attention, the most significant of which are described below.

The OIG conducted an inquiry upon receipt of information from the OIT Security Group that a member of the public purchased an SEC BlackBerry® phone from a vendor on the popular auction website, eBay. During the inquiry, we determined that the vendor bought the device from a company that sold surplus equipment bought from the General

Services Administration (GSA). The OIG obtained the BlackBerry® and, upon examination, determined that it had properly been turned in as defective by a former member of the SEC's Philadelphia Regional Office staff. The device was then wiped clean by OIT staff (although some residual information, e.g., "Property of the SEC," remained) and turned in to GSA as surplus equipment, which GSA then sold in a bulk lot to the public. There was no evidence that the BlackBerry® purchased on eBay was obtained or sold illegally, as it was properly turned over by the OIT to GSA as surplus.

Another inquiry conducted by the OIG concerned alleged staff misconduct with regard to an Enforcement action brought by an SEC regional office, including allegations that two regional office staff attorneys made false representations and committed perjury when they filed the SEC's complaint in the matter. The OIG thoroughly reviewed the lengthy litigation history and court filings in the underlying case, as well as the allegations contained in the complaint. Based on this review, the OIG determined that the allegations against the staff attorneys were unsubstantiated. The OIG further found that the issues set forth in the complaint were previously decided by the United States District Court in which the Enforcement action was brought and upheld on appeal. Thus, the OIG took no further action on the complaint.

The OIG conducted an inquiry after receiving a telephone Hotline complaint from an anonymous source. The complainant reported that since 2004, a large bank has been involved in a Ponzi scheme through its broker-dealer. The complainant further alleged that a senior official in an SEC regional office directed staff to start

investigating the matter only after the Bernard L. Madoff Ponzi scheme became public. After receiving this complaint, we searched internal databases and found that the regional office's investigation of the bank's Ponzi scheme was opened in June 2005, and a formal order of investigation was obtained in October 2006. Based upon its review, the OIG also determined that there was activity in the case, including coordination with DOJ and the FBI, prior to the revelation of the Madoff Ponzi scheme in December 2008. Accordingly, the OIG concluded that this complaint did not warrant further investigation.

The OIG conducted another inquiry into a complaint it received from an SEC accountant, alleging that a former SEC staff member improperly communicated with a third party concerning internal SEC personnel matters. Such a communication, the complainant alleged, was improper under the recently-published SEC Enforcement Manual section prohibiting external communications between senior Enforcement officials and parties outside the SEC. The OIG inquiry determined that although the alleged subject met the definition of a "senior enforcement official," her external communication fell outside the conduct proscribed by the Enforcement Manual as it involved personnel issues of two employees who were previously supervised by the outside person with whom she was speaking. Thus, the conversation was (1) not material; (2) did not relate to an ongoing, active investigation; and (3) did not occur between a senior enforcement official and a person outside the SEC who was involved with investigations. Moreover, the Enforcement Manual did not come into existence until five years after the external communication occurred. In view of these facts, as well as the fact that the subject

of the inquiry is no longer an SEC employee, the OIG determined that no further investigative work was warranted in this matter.

The OIG also concluded its inquiry into a complaint that an SEC employee used the SEC's e-mail system to send personal messages containing Personally Identifiable Information (PII) to an individual outside the agency at his place of employment, despite the complainant's request that the SEC employee stop doing so. The OIG obtained and reviewed the employee's e-mails for the time period relevant to the complaint. For the 24-month period reviewed, the OIG found that the employee sent 133 e-mails to the complainant's personal or work e-mail accounts, or both. The OIG then reviewed a sample of approximately 63 of these e-mails and found that none of these e-mails appeared to be harassing or threatening. Based on its review, the OIG determined that the employee did not make excessive personal use of SEC e-mail under the agency's rules. The OIG also found that the employee did not violate any SEC policies regarding PII, as the information contained in the e-mails was of a personal nature and was not information collected, used or maintained by the SEC.

PENDING INVESTIGATIONS

Investigation of Failure to Uncover a Ponzi Scheme

The OIG is conducting an investigation of why the SEC did not discover that Bernard L. Madoff was running a Ponzi scheme prior to his arrest on December 11, 2008.

The OIG began this investigation in response to a request made on December 16, 2008, by then Commission Chairman

Christopher Cox. Chairman Cox asked IG Kotz to undertake an investigation into complaints made to the Commission regarding Madoff, going back to at least 1999, and the reasons that these allegations were found to be not credible. Chairman Cox also requested that the OIG investigate all staff contact and relationships with the Madoff family and firm and any impact such relationships had on staff decisions regarding the firm.

In testimony given before the United States House of Representatives Committee on Financial Services on January 5, 2009, IG Kotz stated that the OIG would investigate several specific issues, including how the SEC handled complaints it received regarding Madoff; whether examinations of Madoff's firm were affected by conflicts of interest between SEC officials or staff and members of the Madoff family; the extent to which Madoff's reputation, status and professional relationships with SEC staff may have affected decisions regarding investigations and examinations of his firm; and whether there were "red flags" signaling a Ponzi scheme that were overlooked in examinations of Madoff's firm.

Since January 2009, the OIG has ordered the production of the e-mails of at least 27 SEC employees who had involvement with Madoff examinations or investigations and has requested a search of all headquarters and New York and Boston Regional Office e-mails referencing Madoff. The OIT has been producing e-mails on a rolling basis and has provided the OIG with over 1.3 million e-mails to date. OIG investigators have substantially reviewed the e-mails produced. In addition to obtaining internal agency e-mails, the OIG has ordered e-mail providers to preserve the personal e-mail accounts of

several individuals. Additional document requests are underway.

At the request of the OIG, the OCIE produced all available work papers from the SEC's examinations of Madoff's firm. Specifically, the OCIE produced documents from seven examinations performed over 11 years.

The OIG also engaged a forensic and litigation consultancy firm with expertise in forensic accounting and the examination of broker dealers to assist in the review of the OCIE work papers, and to determine whether examiners missed red flags that should have alerted them to Madoff's Ponzi scheme. The consultancy firm has completed a thorough review and analysis of all examination work papers produced to the OIG.

In addition, as of the end of the reporting period, the OIG had conducted 44 witness interviews with numerous additional interviews scheduled for April and May 2009. The OIG hopes to conclude its investigation and issue a report of its findings prior to the end of the next semiannual reporting period.

Allegation of Unauthorized Disclosure of Non-Public Information by a Senior SEC Official

The OIG is conducting an investigation based upon an anonymous complaint alleging that a senior SEC official improperly disclosed non-public information to a large investment bank. The OIG made a document production request to, and collected numerous documents from the Division of Enforcement, the Division of Investment Management, the Division of Corporation Finance, the Division of Trading and Markets, and the Office of the General Counsel. The OIG investigators

have reviewed thousands of e-mails and documents, and have taken the sworn testimony of or interviewed 13 current and former SEC employees during the reporting period. The OIG also provided a briefing to the staff of a United States Senator regarding the status of the investigation. The investigators plan to take additional testimony and issue a written report of investigation in the next semiannual reporting period.

Allegations of Unauthorized Disclosure by Former Employee and Improper Enforcement Investigation

The OIG is continuing to investigate allegations made in a published book that a former SEC attorney may have taken confidential investigative materials when he left the SEC and provided those materials to a company for which he went to work as a lobbyist. It was also alleged in the book that the SEC failed to conduct an adequate investigation after the author presented evidence of fraud by an affiliate of this company and instead investigated the complainant for spreading negative views about the company. The OIG has obtained and reviewed the book containing the allegations and taken the testimony of its author. The OIG has also taken the testimony of individuals who worked on the underlying investigative matter. In addition, the OIG has obtained hundreds of pages of e-mails, as well as relevant correspondence and other documentation. The OIG further plans to take the sworn testimony of and interview several additional witnesses.

Allegations of Failure to Vigorously Enforce Securities Laws

The OIG has opened an investigation into a complaint it received from a shareholders'

representative, alleging that Enforcement failed to properly and vigorously enforce the Federal securities laws in its investigation of a publicly-traded corporation, resulting in substantial losses to shareholders. The OIG has requested and reviewed relevant documents and taken the sworn testimony of the complainant. The OIG plans to interview several SEC staff members with knowledge of the allegations and the underlying Enforcement matter.

Allegations of Conflict of Interest and Investigative Misconduct

The OIG is continuing to investigate allegations that a supervisory SEC Enforcement attorney participated in an investigation notwithstanding a personal conflict of interest that required his recusal from the investigation, and that various misconduct occurred during the course of the investigation and subsequent litigation. During this semiannual reporting period, the OIG continued to review the e-mails of the attorneys who worked on the matter for the relevant time period. The OIG also reviewed additional information received from the complainant and sought clarification from an SEC Office of a new concern raised by the complainant. The OIG plans to take the testimony of the subjects of the investigation and complete the investigation during the next semiannual reporting period.

Complaint Concerning Unauthorized Disclosure of Non-Public Information Obtained from a Commission Database

The OIG is conducting an investigation into a complaint that two SEC Enforcement attorneys repeatedly, and in violation of agency policy, disclosed non-public

information about SEC Enforcement investigations obtained from an internal SEC database. The information in question was allegedly disclosed to a corrupt FBI agent and short seller, who were subsequently tried and convicted of several criminal violations, including fraud, theft, racketeering and conspiracy in connection with a stock short selling operation. During the reporting period, an OIG investigator took sworn, on-the-record testimony of the two Enforcement attorneys who were accused of improperly divulging the non-public information. The OIG also obtained and reviewed the transcripts of the testimony these two attorneys provided at the criminal trial of the FBI agent and short seller. In addition, we requested and examined other documentation, including records showing what information these attorneys searched for in the internal SEC database. The OIG plans to finalize the investigation in the next reporting period.

Allegations of Management Retaliation Against Staff and Travel Abuse

The OIG is investigating two separate matters as a result of an internal complaint alleging retaliation by management for employee objections to policy and management decisions, and irregularities in two trips taken by staff at government expense. The OIG has obtained and reviewed documents pertaining to the office in question, including travel records and vouchers, letters of reprimand, grievance documents and personnel records. The OIG has also taken the sworn testimony of or has interviewed 16 current and former SEC staff and managers. The OIG expects to issue reports of investigation for both matters in the next reporting period.

Complaint Concerning Obstruction of Justice

The OIG is conducting an investigation into a complaint that an SEC employee may be obstructing a Federal investigation. The OIG investigator has obtained and reviewed relevant documents from the SEC and outside entities and is working with other Federal law enforcement agencies in the course of this investigation.

Complaint of Investigative Misconduct by Various Enforcement Attorneys

The OIG has opened an investigation into a complaint received from counsel for a defendant in an SEC Enforcement action, alleging numerous instances of misconduct by several Enforcement staff members during the course of the investigation that resulted in the filing of the action. These allegations included various apparent violations of the Commission's conduct rules and the SEC's polices for conducting Enforcement investigations. At the time it received counsel's complaint, the OIG had a related pending inquiry involving the sending of inappropriate e-mails by an Enforcement attorney. The OIG plans to review the matters covered in the inquiry and conduct an investigation of the allegations of staff misconduct contained in counsel's letter.

Allegation of Negligence in the Conduct of an Enforcement Investigation

The OIG has opened an investigation into a complaint received by a former Enforcement attorney that Enforcement committed acts of negligence in the conduct of an insider trading investigation. The complaint was based upon recently-discovered

information that purports to demonstrate that Enforcement had access to specific evidence that insider trading had occurred prior to Enforcement closing its investigation. The OIG has reviewed documentation provided by the complainant and additional documentation in its possession. The OIG plans to conduct an investigation of the allegations brought to its attention.

Allegation of Unauthorized Disclosure of Non-Public Information to a National Media Outlet

The OIG is completing its investigation into an allegation that SEC staff committed an unauthorized disclosure of non-public SEC information to a national news outlet. The OIG took sworn, on-the-record testimony of 12 SEC staff members from several offices and reviewed several thousand e-mails for relevant information. The OIG plans to issue its report of investigation in this matter during the next semiannual reporting period.

Whistleblower Allegations of Falsification of Contract Documents

The OIG has continued its joint investigation with a Special Agent from another Federal agency Office of Inspector General and an attorney with a United States Attorney's Office into allegations made by a whistleblower that a contractor manipulated data in order to increase the millions of dollars of award fees it had obtained from the SEC over a period of several years. The investigators have reviewed hundreds of documents pertaining to the contract, and have reviewed hundreds of thousands of e-mails relevant to the case. The investigators have also completed numerous interviews of

pertinent witnesses, including the whistleblower, several SEC staff and employees of the other Federal agency. The investigators are working to obtain documentation from the contractor, which has failed to comply with document production requests from the investigating entities. The investigators plan to interview numerous company witnesses and will re-interview an SEC staff member with pertinent information.

Allegation of Conflict of Interest on the Part of a Senior Manager

The OIG continued its investigation into an allegation that an SEC Senior Officer was involved in the decision to hire a contractor with whom he had a past relationship, even though the contractor was not the lowest bidder in the procurement process. During the reporting period, the OIG continued to review the documentary evidence obtained in the investigation and interviewed a human resources specialist who was familiar with the contract in question. In addition to reviewing the allegation of conflict of interest, the OIG has broadened the scope of its investigation to review the contract selection process, as well as communication of the selection to staff. The OIG will conclude its investigation and issue a report on the matter in the next reporting period.

Allegation of Retaliatory Investigation

The OIG has a pending investigation into an allegation that SEC staff engaged in a retaliatory investigation of a company after it publicly complained about naked short selling in the company's stock. The OIG plans to continue this investigation in the upcoming reporting period. Specifically, the OIG

intends to interview additional witnesses identified by the complainant in the matter and to take the sworn, on-the-record testimony of the SEC Enforcement attorneys who worked on the matter.

Allegation of Possession of a Weapon on Federal Property

The OIG is investigating an allegation received near the end of the reporting period that an SEC employee has brought a prohibited weapon to the workplace on more than one occasion, as witnessed by two fellow employees. The allegation of the improper possession of a weapon surfaced in connection with management's inquiry concerning a statement made by the employee in an e-mail to his supervisor that was perceived as threatening. Prior to the end of the reporting period, the OIG conducted interviews of the two employees who reportedly witnessed the weapon on the subject employee's desk. The OIG plans to take the sworn, on-the-record testimony of the subject of the investigation and notify management of the outcome of that testimony.

Allegation of Abusive Behavior and Other Improper Conduct

The OIG has opened an investigation into an allegation that an SEC manager has engaged in a pattern of unprofessional and disruptive behavior while conducting SEC inspections of outside entities. It was further alleged that the manager gave unethical instructions to the staff. During the reporting period, the OIG interviewed several staff members, all of whom requested confidentiality. The OIG plans to continue its investigation by conducting additional

interviews and taking sworn, on-the-record testimony.

Allegations of Abuse of Authority and Patterns of Discrimination

The OIG is conducting an investigation into a complaint that two SEC Enforcement attorneys engaged in an abuse of authority and patterns of discrimination against Native Americans during an SEC investigation of the complainant and his company. During the reporting period, the OIG thoroughly reviewed and analyzed materials provided by the complainant, reviewed pertinent pleadings from the SEC's Enforcement action against the complainant's company, and prepared a comprehensive plan of investigation. In the next reporting period, the OIG plans to take sworn, on-the-record testimony of the complainant and the two Enforcement attorneys who are subjects of the investigation.

Complaint of Misuse of Computer Resources and Official Time

The OIG has opened an investigation into a complaint received from a state government

agency that an SEC employee has been using SEC e-mail resources and official time to assist the business of an outside individual. The OIG obtained the employee's e-mails for an eight-month period and conducted a thorough review of those e-mails. The OIG has obtained and reviewed other documentary evidence and is continuing to cooperate with the state agency's investigation. The OIG plans to interview relevant witnesses and take the sworn, on-the-record testimony of the subject of the investigation.

Allegation of Misuse of Computer Resources by Senior Staff Member

The OIG plans to conduct an investigation into information it received from the SEC's OIT Security Group, that an SEC senior staff member has misused computer resources. Specifically, the information provided to the OIG demonstrates that the senior staff member may be using his SEC-issued computer to view pornographic websites and other inappropriate material. The OIG plans to review the data provided by OIT, as well as other pertinent documentation, take the sworn, on-the-record testimony of the senior staff member, and interview other SEC staff as necessary.



SEMIANNUAL REPORT TO CONGRESS

REVIEW OF LEGISLATION AND REGULATIONS

During the reporting period, the OIG reviewed legislation and proposed and final rules and regulations relating to the programs and operations of the SEC, pursuant to Section 4(a)(2) of the Inspector General Act. As discussed in the Advice and Assistance Provided to the Agency Section of this Report, the OIG provided comments on several proposed internal regulations and procedures. These included, among others, draft SEC Regulations (SECR) on the Use of SEC Office Equipment (SECR 24-4.3), the SEC’s Privacy Program (SECR 24-08), and the SEC’s Paperwork Reduction Act Program (SECR 24-09), as well as the SEC Rules of the Road (SECR 24-04.A01).

In addition, the OIG reviewed statutes, rules and regulations and requirements, and their impact on Commission programs and operations, within the context of audits and reviews conducted during the period. For example, in the audit performed of the Division of Corporation Finance’s (CF) Regulation D Exemption Process, we comprehensively examined the SEC rules known as Regulation D, 17 C.F.R. §§

230.501-508. In our audit report, we specifically recommended that CF discuss the merits of proposed changes to Regulation D with the Chairman, the Commissioners and Commission senior staff, including the possibility of making the filing of a Form D a required condition for entities to claim the Regulation D exemptions. Further, during our review of the SEC’s restacking project, we carefully reviewed the SEC’s existing unsigned space management regulation (SECR 5-8) and compared it with the SEC’s more comprehensive regulation concerning Information Technology Capital Planning and Investment Control (SECR 24-02). Based upon our review, we recommended that the agency, using SECR 24-02 as guidance, develop and adopt policies and procedures to make its guidance for investment in space more consistent with pertinent OMB guidance.

In coordination with the Legislation Committee of the CIGIE, the OIG closely reviewed and tracked various legislation that, among other things (1) would impact and give enhanced authority to Inspectors General;

(2) created and would provide additional powers to the Special Inspector General for the TARP; and (3) created the Recovery Transparency and Accountability Board.

Additionally, the OIG reviewed and commented on legislation that would provide additional funding for the SEC and specifically the OIG.



SEMIANNUAL REPORT TO CONGRESS

STATUS OF RECOMMENDATIONS WITH NO MANAGEMENT DECISIONS

Management decisions have been made on all audit reports issued before the beginning of this reporting period.

REVISED MANAGEMENT DECISIONS

No management decisions were revised during the period.

AGREEMENT WITH SIGNIFICANT MANAGEMENT DECISIONS

The Office of Inspector General agrees with all significant management decisions regarding audit recommendations.

INSTANCES WHERE INFORMATION WAS REFUSED

During this reporting period, there were no instances where information was refused.

Table 1 List of Reports: Audits and Evaluations

Audit / Evaluation Number	Title	Date Issued
448	2008 Audit of Sensitive Payments	Mar 27, 2009
450	Practices Related to Naked Short Selling Complaints and Referrals	Mar 18, 2009
452	Division of Enforcement's Disgorgement Waivers	Feb 3, 2009
456	Audit of Public Transportation Benefit Program	Mar 27, 2009
459	Regulation D Exemption Process	Mar 31, 2009
461	Review of the Commission's Restacking Project	Mar 31, 2009
462	CTR System Report – 2008 FISMA	Feb 27, 2009
463	OASIS System Report - 2008 FISMA	Mar 24, 2009

Table 2 Reports Issued With Costs Questioned or Funds Put to Better Use (including disallowed costs)

	Number of Reports	Value
A. REPORTS ISSUED PRIOR TO THIS PERIOD		
For which no management decision had been made on any issue at the commencement of the reporting period	1	\$5,604.00
For which some decisions had been made on some issues at the commencement of the reporting period	1	\$129,336.00
B. REPORTS ISSUED DURING THIS PERIOD	3	\$392,169.17
TOTAL OF CATEGORIES A AND B	5	\$527,109.17
C. For which final management decisions were made during this period	2	\$6,223.00
D. For which no management decisions were made during this period	2	\$391,550.17
E. For which management decisions were made on some issues during this period	0	0
TOTAL OF CATEGORIES C, D AND E	4	\$397,773.17

Table 3 Reports With Recommendations on Which Corrective Action Has Not Been Completed

RECOMMENDATIONS OPEN 180 DAYS OR MORE

Audit/Inspection/ Evaluation # and Title	Issue Date	Summary of Recommendation
365 - IT Capital Investment Decision-Making Follow-Up	03/29/2004	Publish a charter for the Information Officers Council.
393 - Software Management	03/24/2005	Enhance manual controls for software management.
		Implement preventive controls for software management.
		Develop written policies and procedures for software management.
		Perform periodic inventories of software and hardware.
		Develop procedures for software acquired by contractors.
395 - Field Offices' Integrity Program	05/31/2005	Complete the development of an employee manual.
402 - Office of the Secretary	09/20/2005	Develop a regulation involving updating and posting public company forms on the Commission's website.
412 - Oversight of PCAOB	09/28/2006	Review the Public Company Accounting Oversight Board's (PCAOB) disaster contingency plan.
		Develop procedures for several PCAOB oversight issues.

Audit/Inspection/ Evaluation # and Title	Issue Date	Summary of Recommendation
417 - Systems Security Evaluations - Blue Sheets	03/22/2007	Ensure analysis of security impact for system modifications.
421 - Investment Company Disclosure Initiatives	09/25/2007	Develop outcome-based performance indicators for disclosure initiatives.
428 - Electronic Documents Program	07/25/2007	Issue program guidance.
		Ensure adequate data loading and quality assurance.
		Develop written procedures for loading data work from the regional offices.
		Consider a larger forensics lab.
		Research connectivity problems with Concordance system.
		Issue guidance on the preservation of electronic records.
		Decrease and track imaging turnaround times.
		Perform background investigations for 13 identified contract employees.
430 - Contract Ratifications	09/25/2007	Update SEC Regulation (SECR 10-2) to incorporate requirements.
		Reevaluate procurement in the regional offices.
		Develop procurement procedures and provide training for the regional offices.
		Determine necessary training on expert witness contracts.

Audit/Inspection/ Evaluation # and Title	Issue Date	Summary of Recommendation
		Consider requiring appointment letters for Inspection and Acceptance Officials and Point of Contact Officials (normally trial attorneys).
		Add disciplinary language to ratification guidance.
		Develop procedures to compile contract ratification data semiannually.
432 - Oversight of Receivers and Distribution Agents	12/12/2007	Decide how often and in what format receiver/distribution agent information should be submitted.
		Request final accounting from receivers/distribution agents.
		Provide guidance and training to Division of Enforcement (Enforcement) staff on receiver/distribution agent oversight.
433 - Inspection of Corporation Finance Referrals	09/30/2008	Develop a centralized tracking system for Enforcement and Division of Corporation Finance (CF) staff regarding non-delinquent filer referrals.
		Record outcome information for non-delinquent filer referrals.
		Enhance CF's gatekeeper role once outcome information becomes more available.
434 - Background Investigations	03/28/2008	Develop or acquire a case management tracking system.
436 - Usefulness of IM's Website	03/28/2008	Identify clear and specific objectives for Investment Management's (IM) Intranet and discuss objectives with IM's Information Technology (IT) staff.
		Improve Intranet including developing an appropriate project plan that incorporates applicable website best practices and systems development processes.
437 - Security Enhancements in SP Parking Garage	10/22/2007	Install cameras in Station Place parking garage.

Audit/Inspection/ Evaluation # and Title	Issue Date	Summary of Recommendation
438 - SRO Rule Filing Process	03/31/2008	Enhance Self Regulatory Organization Rule Tracking System by identifying comment letters, improving speed, retaining proposed rule changes in inbox, and ensuring uploading of comment letters.
439 - Student Loan Program	03/27/2008	Undertake actions to delegate in writing authority for approving waivers, amend Form 2497, and issue guidance for approval requirements of Student Loan Program (SLP) awards.
		Review Office of Personnel Management regulation to ensure proper individual approves SLP awards.
		Ensure SLP files contain appropriate documentation of repayments by employees not completing service agreements.
		Ensure documentation in SLP files correctly indicates who prepared/reviewed the payments.
		Implement methods to mitigate the risk of fraudulent documentation submitted by employees.
		Ensure the reliability of management records regarding former employees.
		Review the reliability of management records involving former employees.
		Implement a separation of duties in the review, processing and approval of SLP awards.
		Consult with the Department of Interior to ensure that monies owed to the Commission are collected, documented and recorded in a timely manner.
		Conduct a thorough review of the employee clearance process to initiate improvements.
		Implement recommendations of contractor retained by the Office of Financial Management to increase the likelihood of collection of employee debts relating to the SLP or, if not feasible, prepare a report explaining why the recommendations were not implemented.

Audit/Inspection/ Evaluation # and Title	Issue Date	Summary of Recommendation
		In consultation with the Union, provide supervisors with guidance on preparing substantial justification memoranda.
		Return to supervisors justification memoranda that lack substantiation of the criteria.
		Prepare document regarding the required criteria for justification memoranda for the 2008 Open Season.
		Implement an automated process for monitoring lifetime awards before the 2009 Open Season.
		Develop a plan to obtain data and a methodology to analyze and record data to comply with Collective Bargaining Agreement requirements.
		In consultation with the Union, develop a detailed distribution plan.
440 - Internal Control Review of Government Purchase Card Program	09/18/2008	Revise SEC Regulation (SECR 10-6) to reflect the relevant procedures for cardholders to follow and update it periodically.
		Revise SECR 10-6 and require cardholders to retain all relevant documentation in their files in an accessible manner.
		Revise SECR 10-6 to ensure compliance with the Federal Acquisition Regulation regarding vendor quotes and the \$3,000 micro-purchase threshold.
		Revise SECR 10-6 to reflect current practices for approving IT purchases with purchase card and to emphasize importance of Office of Information Technology (OIT) approval of such purchases.
		Verify that end-of-year open obligations are rolled into the next fiscal year.
		Ensure completion of training and signed letter of delegation before issuing a purchase card.
		Revise SECR 10-6 to require notification about departing cardholders and immediately suspend the purchase card.

Audit/Inspection/ Evaluation # and Title	Issue Date	Summary of Recommendation
		Revise SECR 10-6 to ensure that the program coordinator does not have direct access to a purchase card.
441 - Controls Over Laptops	03/31/2008	Require a method of accountability for sensitive property to ensure accurate accounting of laptops.
		Through OIT's Asset Management Branch (AMB), complete a full inventory of laptops to establish baseline level.
		Through the AMB, revise procedures to establish clear accountability for laptops.
		Specify a form to account for sensitive property, and include contact information for recipient of equipment.
442 - Enterprise Architecture Assessment	03/31/2008	Develop Enterprise Architecture (EA) metrics to assess or track Commission's performance in implementing and tracking performance of SEC Federal Enterprise Architecture (FEA) program.
		Through the Information Technology Capital Planning and Investment Control Board, require periodic reports on EA progress overall, including specifically how EA can help to make strategic purchasing decisions.
		Reconstitute EA Working Group as an EA Steering Committee.
		Require the EA Steering Committee to report to the Information Technology Capital Planning Committee (ITCPC)/Executive Operations Committee and that the ITCPC consider input from EA to make strategic purchasing decisions.
		Create subcommittees on Data Management, Technology Standards, IT Strategy and other areas of focus.
		Involve EA in all technology implementations, especially ones that are "fast tracked."
		Through high-level policy makers, establish a process that ensures participation from the EA team prior to approving IT initiatives.

Audit/Inspection/ Evaluation # and Title	Issue Date	Summary of Recommendation
443 - Internet Use Policies and Rules	11/15/2007	Update and clarify Internet usage policies.
		Clarify pornography definition and send staff reminders.
446A - SEC's Oversight of Bear Stearns and Related Entities: CSE Program	09/25/2008	Reassess the guidelines and rules for capital levels of Consolidated Supervised Entity (CSE) firms and identify instances when firms should be required to raise additional capital.
		Reassess Pillar 2 of the Basel II framework and CSE program guidelines regarding liquidity and make appropriate changes to program's liquidity requirements.
		Incorporate a firm's concentration of securities into the CSE program's assessment of the firm's risk management systems and more aggressively prompt firms to take appropriate actions to mitigate such risks.
		Reassess the CSE program's policy regarding leverage ratio limits and determine under what circumstances to impose leverage ratio limits on the CSEs.
		Ensure that CSE firms have specific criteria for reviewing and approving models used for pricing and risk management, and that the review and approval process is performed independently, thoroughly, and timely; impose limits on risk taking by firms if it is determined that the firm's risk management is not adequate.
		Be more skeptical of the CSE firms' risk models and work with the firms on developing additional stress scenarios.
		Be involved in the formulation of action plans for a variety of distress or disaster scenarios, including plans for every stress scenario that CSE firms use in risk management.
		Ensure that mark disputes do not enable CSE firms to inflate the combined capital of two firms by using inconsistent marks.
		Encourage CSE firms to use VaR (Value-at-Risk) and other risk management data in a manner consistent with how the firms use the data internally and that allows the risk factors to be applied consistently to trading desks.

Audit/Inspection/ Evaluation # and Title	Issue Date	Summary of Recommendation
		Ensure that CSE firms take appropriate valuation deductions for illiquid, hard-to-value assets and appropriate capital deductions for stressed repos.
		Discuss risk tolerance with the CSE firms' Board of Directors and senior management.
		Require compliance with existing rule requiring external auditors to review the CSE firms' risk management control systems, or seek Commission approval for deviation from this requirement.
		Ensure that reviews of a CSE firm's Contingency Funding Plan include an assessment of the firm's internal and external communication strategies.
		Reassess all prior Office of Compliance Inspections and Examinations (OCIE) issues to ensure no significant issues are unresolved, and follow up on all significant unresolved issues.
		Improve collaboration between the Divisions of Trading and Markets (TM) and Corporation Finance (CF), and determine whether CSE program information could be used in CF's filing reviews.
		Develop a collaboration agreement between TM and OCIE that maintains a clear delineation of responsibilities and inform the Chairman's Office of any disagreements.
		Develop an agreement between TM and the Office of Risk Assessment (ORA) that outlines their roles and responsibilities and methods of information sharing, such as communicating project results, and notify the Chairman's Office of any disagreements.
		Develop internal guidelines for timely CF filing reviews, and track and monitor compliance with these guidelines.
		Establish a policy outlining when firms are expected to respond substantively to issues raised in CF comment letters, and track and monitor compliance with this policy.
		Create a task force led by ORA to determine the costs and benefits of supervising on a consolidated basis large firms that hold significant amounts of customer funds and have unregulated entities.
		Determine what additional changes need to be made to the CSE program in light of the collapse of Bear Stearns and the changing economic environment.

Audit/Inspection/ Evaluation # and Title	Issue Date	Summary of Recommendation
		Fill critical staff positions and assess whether additional staff will be needed to carry out the CSE program's function going forward; establish milestones for completing each phase of an inspection and implement a procedure to ensure the milestones are met.
		Continue to seek ways to increase communication, coordination, and information sharing with the Federal Reserve and other Federal regulators.
446B - SEC's Oversight of Bear Stearns and Related Entities: Broker-Dealer Risk Assessment Program	09/25/2008	Establish a timeframe to update and finalize temporary rules 17h-1T and 17h-2T within six months.
		Determine whether Bear Stearns and the broker-dealers (BDs) of the other CSE firms are required to file Form 17-H and, if it is determined they are required to file the form, enforce compliance with the filing requirement and timely process and review these filings.
		At least annually remind the BDs subject to the Broker-Dealer Risk Assessment (BDRA) program of their obligation to retain the information specified in temporary rule 17h-1T, and determine BD compliance with this requirement.
		Comply with written policy to document the staff's review of quarterly 17(h) filings with a written memorandum, or update written policy appropriately to ensure review of 17(h) filings is properly and adequately documented.
		Develop within three months a current list, with supporting documentation, of all BDs that are exempt from filing Form 17-H, and continuously update this list.
		Aggressively encourage firms to file Form 17-H electronically, using the BDRA system.
		Ensure the BDRA system includes financial information, staff notes and other written documentation and is used to generate management reports.
		Resolve technical problems with the BDRA system.
447 - Audit of Premium Travel	09/29/2008	Revise current policies and procedures to ensure they are comprehensive and current.

Audit/Inspection/ Evaluation # and Title	Issue Date	Summary of Recommendation
		Update the current travel website to ensure all travel policies and procedures, including those on travel upgrades, are maintained electronically in one location for easy retrieval.
		Enhance travel computer system to produce travel upgrade data and implement procedures to ensure all upgrades are approved prior to travel.
		Implement policy prohibiting subordinates from approving supervisors' travel.
		Revise current policy to address situations involving travel from a telework location and prohibit travel from a telework location if it results in additional cost to the SEC.
		Enforce immediately and include in policies and procedures the Office of Management and Budget's (OMB) requirement to restrict premium class travel for temporary duty when the employee is not required to report for duty the following day.
449 - Survey of Enforcement's HUB System	09/29/2008	Develop formal written policies for entering information into the HUB system, including clearly defining roles and responsibilities of staff, and ensure system users are aware of and have access to the policies.
		Perform an assessment of authorized users to ensure the proper personnel are utilizing the system fully and appropriately, and add a date requirement for "Authorities Consulted and Referrals to Other Regulators."
		Finalize the reports feature and incorporate the ability to develop customized reports that can be exported into spreadsheets.
		Ensure the Hub system users become aware of the system's features and advantages.
		Review the OIG survey comments to identify areas that can be enhanced within the Hub system.
451 - 2008 FISMA Executive Summary Report	09/29/2008	Complete the security controls and contingency plan testing for the remaining systems.
		Address certain requirements, including modifying all contracts related to common security settings to include the new Federal Acquisition Regulation 2007-004 language.

Audit/Inspection/ Evaluation # and Title	Issue Date	Summary of Recommendation
		Use this Executive Summary Report, along with the completed OIG reporting template, to develop the SEC's annual consolidated Federal Information Security Management Act Report in accordance with OMB Memorandum M-08-21.
454 - The Division of Enforcement's Draft Policies and Procedures Governing the Selection of Receivers, Fund Administrators, Independent Distribution Consultants, Tax Administrators and Independent Consultants	09/16/2008	Revise policy on the selection of receivers and independent consultants to address actual and apparent conflicts of interest and provide guidance to staff.
		Determine whether any time limit should be placed on a request for conflict of interest or background information, or whether that information should be requested for more than five years.
		Include in attachment to policy the applicant's certification that the information provided is complete and truthful and that the applicant understands the consequences for providing false information.
455 - Attorney Annual Certification of Bar Membership	09/09/2008	Require all SEC attorneys to certify annually that they are active bar members and to acknowledge that their failure to maintain active bar membership may result in referral to the appropriate authorities and/or disciplinary action.

Table 4 Summary of Investigative Activity

CASES	NUMBER
Cases Open as of 9/30/08	17
Cases Opened during 10/1/08 - 3/31/09	14
Cases Closed during 10/1/08 - 3/31/09	10
Total Open Cases as of 3/31/09	21
Referrals to Department of Justice for Prosecution	3
Prosecutions	0
Convictions	0
Referrals to Agency for Disciplinary Action	10
PRELIMINARY INQUIRIES	NUMBER
Inquiries Open as of 9/30/08	23
Inquiries Opened during 10/1/08 - 3/31/09	69
Inquiries Closed during 10/1/08 - 3/31/09	43
Total Open Inquiries as of 3/31/09	49
Referrals to Agency for Disciplinary Action	4
DISCIPLINARY ACTIONS	NUMBER
Removals (Including Resignations)	4
Suspensions	0
Reprimands	4
Warnings/Other Actions	1

Table 5 Summary of Complaint Activity

DESCRIPTION	NUMBER
Complaints Pending Disposition at Beginning of Period	4
Hotline Complaints Received	178
Other Complaints Received	96
Total Complaints Received	274
Complaints on which a Decision was Made	260
Complaints Awaiting Disposition at End of Period	18
Disposition of Complaints During the Period	
Complaints Resulting in Investigations	11
Complaints Resulting in Inquiries	62
Complaints Referred to OIG Office of Audits	5
Complaints Referred to Other Agency Components	133
Complaints Referred to Other Agencies	10
Complaints Included in Ongoing Investigations or Inquiries	7
Response Sent/Additional Information Requested	27
No Action Needed	12

Table 6 References to Reporting Requirements of the Inspector General Act

The Inspector General Act of 1978, as amended, specifies reporting requirements for semiannual reports to Congress. The requirements are listed below and indexed to the applicable pages.

	INSPECTOR GENERAL ACT REPORTING REQUIREMENT	PAGES
Section 4(a)(2)	Review of Legislation and Regulations	65-66
Section 5(a)(1)	Significant Problems, Abuses, and Deficiencies	11-13, 16-36, 40-58
Section 5(a)(2)	Recommendations for Corrective Action	11-13, 16-36, 40-58
Section 5(a)(3)	Prior Recommendations Not Yet Implemented	73-83
Section 5(a)(4)	Matters Referred to Prosecutive Authorities	40-58, 85
Section 5(a)(5)	Summary of Instances Where Information Was Unreasonably Refused or Not Provided	67
Section 5(a)(6)	List of OIG Audit, Inspection and Evaluation Reports Issued During the Period	69
Section 5(a)(7)	Summary of Significant Reports Issued During the Period	16-36, 40-58
Section 5(a)(8)	Statistical Table on Management Decisions with Respect to Questioned Costs	71
Section 5(a)(9)	Statistical Table on Management Decisions on Recommendations That Funds Be Put To Better Use	71
Section 5(a)(10)	Summary of Each Audit, Inspection or Evaluation Report Over Six Months Old for Which No Management Decision Has Been Made	67
Section 5(a)(11)	Significant Revised Management Decisions	67
Section 5(a)(12)	Significant Management Decisions with Which the Inspector General Disagreed	67

**Testimony of H. David Kotz
Inspector General of the
Securities and Exchange Commission**



**Before the U.S. House of Representatives
Committee on Financial Services**

**Monday, January 5, 2009
2:00 p.m.**

Introduction

Good afternoon. Thank you for the opportunity to testify today before this Committee on the subject of “Assessing the Madoff Ponzi Scheme” as the Inspector General of the Securities and Exchange Commission (“SEC” or “Commission”). I appreciate the interest of the Chairman, as well as the other members of the Committee, in the SEC and the Office of Inspector General. In my testimony today, I am representing the Office of Inspector General, and the views that I express are those of my Office, and do not necessarily reflect the views of the Commission or any Commissioners.

I would like to begin my brief remarks this afternoon by discussing the role of my Office and the oversight efforts that we have undertaken since I was appointed as the Inspector General of the SEC approximately one year ago, in late December 2007.

The mission of the Office of Inspector General is to promote the integrity, efficiency and effectiveness of the critical programs and operations of the Securities and Exchange Commission. I firmly believe that this mission is best achieved by having a vigorous and independent Office of Inspector General to investigate and audit Commission activities and to keep the Commission and Congress informed of significant issues and findings.

The SEC Office of Inspector General includes the positions of Inspector General, Deputy Inspector General, Counsel to the Inspector General, and has staff in two major areas: Audits and Investigations. Our audit unit conducts, coordinates and supervises independent audits and evaluations related to the Commission’s internal programs and operations. The primary purpose of conducting an audit is to review past events with a

view toward ensuring compliance with applicable laws, rules and regulations and improving future performance. Upon completion of an audit or evaluation, the OIG issues an independent report that identifies any deficiencies in Commission operations, programs, activities, or functions and makes recommendations for improvements in existing controls and procedures.

The Office's investigations unit responds to allegations of violations of statutes, rules and regulations, and other misconduct by Commission staff and contractors. We carefully review and analyze the complaints we receive and, if warranted, conduct a preliminary inquiry or full investigation into a matter. The misconduct investigated ranges from fraud and other types of criminal conduct to violations of Commission rules and policies and the Government-wide conduct standards. The investigations unit conducts thorough and independent investigations into allegations received in accordance with National Investigative Quality Standards. Where allegations of criminal conduct are involved, we notify and work with the Department of Justice and the Federal Bureau of Investigation as appropriate.

Audit Reports

I am proud to report that notwithstanding a small staff, the Office of Inspector General at the SEC has issued numerous audit and investigative reports over the past year involving issues critical to SEC operations and the investing public.

In September 2008, our audit unit issued a comprehensive report analyzing the Commission's oversight of the SEC's Consolidated Supervised Entity (CSE) program, which included Bear Stearns, Goldman Sachs, Morgan Stanley, Merrill Lynch and Lehman Brothers. The report provided a detailed examination of the adequacy of the

Commission's monitoring of Bear Stearns, including the factors that led to its collapse. The audit identified deficiencies in the CSE program that warranted improvement and identified 26 recommendations that, if implemented, would have significantly improved the Commission's oversight of the CSE firms. The Office of Inspector General audit unit also issued a second report during the same time period, analyzing the Commission's Broker-Dealer Risk Assessment program. This program operates pursuant to SEC rules which require broker-dealers that are part of a holding company structure with at least \$20 million in capital to register with the Commission and provide information on the broker-dealer, the holding company, and other entities within the holding company system. The audit found that the SEC was not fulfilling all of its obligations in connection with the Broker-Dealer Risk Assessment Program and made several recommendations to improve the program.

The Office of Inspector General's audit unit has also issued numerous other reports over the past year relating to issues such as the Self-Regulatory Organization (SRO) rule filing process, the Commission's Personnel Security/Suitability program, the Division of Enforcement's oversight of receivers and distribution agents and its case-management system, the SEC government purchase card program, the Office of Financial Management's controls over premium travel, the Commission's student loan repayment program, and numerous Office of Information Technology issues such as information security, enterprise architecture, and appropriate controls over laptop computers. These audits are described in our semiannual reports to Congress and the individual audit reports are available on our website.

Investigative Reports

We also have a vibrant and vigorous investigative unit that is conducting or has completed over 50 comprehensive investigations of allegations of violations of statutes, rules and regulations, and other misconduct by Commission staff members and contractors. Several of these investigations involved senior-level Commission employees and represent matters of great concern to the Commission, Congressional officials and the general public. Where appropriate, we have reported evidence of improper conduct and made recommendations for disciplinary actions, including terminations. Specifically, over the past year, we have issued investigative reports regarding claims of improper preferential treatment given to prominent persons, retaliatory termination, the failure by the Division of Enforcement to vigorously pursue an Enforcement investigation, conflicts of interest involving an Enforcement investigation and concerning the solicitation of services by an outside contractor, perjury by supervisory Commission attorneys, misrepresentation of professional credentials, falsification of personnel forms and the misuse of official positions and government resources. Where appropriate, we have also referred our investigative findings to the Department of Justice for possible criminal prosecution. We are continuing to follow up with the Department and the Federal Bureau of Investigations on several ongoing criminal matters.

The Madoff Investigation

It is with this background in mind that I wish to discuss our planned efforts to investigate matters related to Bernard Madoff and affiliated entities. On the late evening of December 16, 2008, SEC Chairman Christopher Cox contacted me and asked my

office to undertake an investigation into allegations made to the SEC regarding Mr. Madoff, going back to at least 1999, and the reasons that these allegations were found to be not credible. The Chairman also asked that we investigate the SEC's internal policies that govern when allegations of fraudulent activity should be brought to the Commission, whether those policies were followed, and whether improvements to those policies are necessary. In addition, he requested that the investigation include all staff contact and relationships with the Madoff family and firm, and any impact such relationships had on staff decisions regarding the firm.

Early on December 17, 2008, we opened an official investigation into the Madoff matter. Since then, we have been working at a rapid pace to begin this important work. On December 18, 2008, we issued a document preservation notice to the entire Commission informing them that the Office of Inspector General has initiated an investigation regarding all Commission examinations, investigations or inquiries involving Bernard L. Madoff Investment Securities, LLC, and any related individuals or entities. We formally requested that each employee and contractor in the Commission preserve all electronically-stored information and paper records related to Bernard L. Madoff Investment Securities, LLC in their original format.

Over the next few days, we met with senior officials from the Commission's Division of Enforcement and the Office of Compliance Inspections and Examinations, known as "OCIE," to ensure their cooperation in our investigation and our ability to gain access to their files and records. We also met with the Chairman's office to seek information and documentation relevant to the investigation.

On December 24, 2008, we sent comprehensive document requests to both the Division of Enforcement and OCIE specifying the documents and records we required to be produced for the investigation. We requested that all responsive documents be provided to our Office by January 16, 2009. In addition, we made several formal expedited requests to the SEC's Office of Information Technology for searches of the e-mails of former and current employees and contractors for information relevant to the investigation, both at headquarters and the New York and Boston Regional Offices, and have already received and are in the process of reviewing these e-mails.

We have also already begun efforts to obtain additional resources to assist the Office in undertaking this investigation. We are securing additional office space and administrative assistance and hope to add four new investigators to our Office's current investigative team.

We have also begun identifying the particular issues that need to be investigated and are reviewing and updating daily the list of witnesses that we plan to interview. We intend to begin conducting these interviews immediately and, for example, have already scheduled a meeting with Harry Markopoulos for later this month for an in-depth interview on the record. We have also already met and spoken with numerous individuals informally as part of our initial investigative efforts.

It is our opinion that the matters that must be analyzed regarding the SEC and Bernard Madoff may go beyond the specific issues that SEC Chairman Cox has asked us to investigate. We believe that in addition to conducting a thorough and comprehensive investigation of the specific complaints that were allegedly brought to the SEC's attention regarding Mr. Madoff and the reasons for the SEC's apparent failure to act upon these

complaints, as well as the staff's contact and relationships with the Madoff family and firm and their impact on Commission decisions regarding Mr. Madoff, our oversight efforts must include an evaluation of broader issues regarding the overall operations of the Division of Enforcement and OCIE that would bear on the specific questions we are examining, and provide overarching and comprehensive recommendations to ensure that the Commission fulfills its mission of protecting investors, facilitating capital formation and maintaining fair, orderly and efficient markets.

At this early stage, I thought it would be useful to identify the specific issues related to Bernard Madoff that, as a preliminary matter, we intend to investigate or review. Obviously, as the investigative efforts are just beginning, I am not in a position to provide any conclusions or findings with regard to the allegations that have been raised and do not wish to make any preliminary judgments before we have had a chance to analyze all the information. In addition, as underlying evidence relevant to the work of the Office of Inspector General could also be relevant to the pending criminal or SEC investigations into possible violations of the securities laws, I am being mindful not to comment on anything that may affect or interfere with those investigations.

The following are specific issues that we currently intend to investigate:

(a) The SEC's response to complaints it received regarding the activities of Bernard Madoff, including any complaints sent to the Division of Enforcement, OCIE, the Office of Risk Assessment and/or the Office of Investor Education and Advocacy. We plan to trace the path of these complaints through the Commission from inception, reviewing what, if any, investigative or other work was conducted with respect to these allegations, and analyze whether the complaints were handled in accordance with

Commission policies and procedures and whether further work should have been conducted;

(b) Allegations of conflicts of interest regarding relationships between any SEC officials or staff and members of the Madoff family, including examining the role a former SEC official who allegedly had a personal relationship with a Madoff family member may have played in the examination or other work conducted by the SEC with respect to Bernard Madoff or related entities, and whether such role or such relationship in any way affected the manner in which the SEC conducted its regulatory oversight of Bernard Madoff and any related entities;

(c) The conduct of examinations and/or inspections of Bernard Madoff Investment Securities LLC by the SEC and an analysis of whether there were “red flags” that were overlooked by SEC examiners and inspectors (which may have been identified by other entities conducting due diligence), that could have led to a more comprehensive examination and inspection, including a review of whether the SEC violated its own policies and procedures by not conducting timely reviews or examinations of Bernard Madoff’s activities and filings; and

(d) The extent to which the reputation and status of Bernard Madoff and the fact that he served on SEC Advisory Committees, participated on securities industry boards and panels, and had social and professional relationships with SEC officials, may have affected Commission decisions regarding investigations, examinations and inspections of his firm.

In addition to these specific issues and depending upon the information that we learn during the course of our investigation, we plan to consider analyzing the following broader issues, as appropriate:

(a) The complaint handling procedures of the Division of Enforcement, including a review of how complaints are processed, internal incentives that may affect the decision whether to take action with respect to a complaint, an analysis of which complaints are brought to the Commissioners' and Chairman's attention, and whether tangible and specific complaints are being reviewed and followed-up on appropriately;

(b) The OCIE examination and inspection procedures, including an analysis of what policies and procedures were then and are currently in place, whether these policies and procedures are being followed and/or whether there are gaps in these policies and procedures relating to operations involving voluntary private investment pools, such as hedge funds, because they are subject to limited oversight by the SEC, and whether any such gaps may lead to fraudulent activities not being detected; and

(c) The relationships between different divisions and offices within the Commission and whether there is sufficient intra-agency collaboration and communication between the Agency components to ensure comprehensive oversight of regulated entities.

Obviously, this is an ambitious investigative agenda, but I firmly believe that the circumstances surrounding the Bernard Madoff matter may very well dictate a more expansive analysis of Commission operations. Moreover, it is my view that at the end of these investigative efforts, there needs to be more than just the potential identification of individuals who may have engaged in inappropriate behavior or potentially failed to

follow-up appropriately on complaints, but rather an attempt to provide the Commission with concrete and specific recommendations as appropriate to ensure that the SEC has sufficient systems and resources to enable it to respond appropriately and effectively to complaints and detect fraud through its examinations and inspections.

Of course, even with a limited staff and with many of our auditors and investigators already engaged in ongoing matters, some of which should simply not be halted even in the face of a significant priority such as this one, I understand that it is critical that our investigative efforts be conducted expeditiously. I fully understand that it is crucial for the Commission, the Congress and the investing public that answers be given to the very serious questions regarding the SEC's earlier efforts relating to Mr. Madoff in a prompt and swift manner. For this reason, as I mentioned, I am mobilizing additional resources to ensure that our Office makes every possible effort to conclude our investigations and reviews as soon as possible. We are considering preparing reports on a "rolling basis" – assuming that we can identify discrete issues that may be resolved separately and expeditiously – so that some conclusions may be provided very shortly.

Finally, I can assure you that our investigation and review will be independent and as hard-hitting as necessary. While we approach these efforts with an open mind and at this stage of the investigation we have not reached any conclusions or made any findings, the matters that have been brought to our attention require careful scrutiny and review. We will conduct our work in a comprehensive and thorough manner and, if we find that criticism of the SEC is warranted and supported by the facts, we will not hesitate to report the facts and conclusions as we find them. I think that if you review the reports issued by our office over the past year, you will see that where we have found that

criticism of the SEC or SEC officials to be warranted, we have reported our findings and concerns in a frank, yet constructive manner.

Concluding Remarks

In conclusion, we appreciate the Chairman's and the Committee's interest in the SEC and our Office. I believe that the Committee's and Congress's involvement with the SEC is helpful to strengthen the accountability and effectiveness of the Commission. I believe very strongly that a dynamic and effective Office of Inspector General is critical to achieving the aims of all federal agencies, including the SEC, and take very seriously our Office's responsibility to promote efficiency and effectiveness within the Commission and to detect and report waste, fraud and abuse. We intend to conduct our investigative efforts promptly and thoroughly. Thank you.

**Testimony of H. David Kotz
Inspector General of the
Securities and Exchange Commission**



**Before the Subcommittee on Government
Management, Organization, and Procurement,
Committee on Oversight and Government Reform,
U.S. House of Representatives**

**Wednesday March 25, 2009
2:00 p.m.**

Introduction

Good afternoon. Thank you for the opportunity to testify today before this Subcommittee on the subject of “The Roles and Responsibilities of Inspectors General within Financial Regulatory Agencies” as the Inspector General of the Securities and Exchange Commission (“SEC” or “Commission”). I appreciate the interest of the members of the Subcommittee in the SEC and the Office of Inspector General at this critical time for the financial markets. In my testimony today, I am representing the Office of Inspector General, and the views that I express are those of my Office, and do not necessarily reflect the views of the Commission or any Commissioners.

I would like to begin my remarks this afternoon by discussing the role of my Office and, in particular, the increased oversight efforts we have undertaken since I was appointed as the Inspector General of the SEC a little over one year ago, in late December 2007.

The mission of the Office of Inspector General is to promote the integrity, efficiency and effectiveness of the critical programs and operations of the SEC. This mission has become increasingly important in light of the current economic crisis facing our nation. I firmly believe that this mission is best achieved by having a vigorous and independent Office of Inspector General to investigate and audit Commission activities and to keep the Commission and Congress informed of significant issues and findings.

The SEC Office of Inspector General includes the positions of the Inspector General, Deputy Inspector General, Counsel to the Inspector General, and has staff in two major areas: Audits and Investigations.

Our audit unit conducts, coordinates and supervises independent audits and

inspections related to the Commission's internal programs and operations. The primary purpose of conducting an audit is to review past events with a view toward ensuring compliance with applicable laws, rules and regulations and improving future performance. Upon completion of an audit or evaluation, the OIG issues an independent report that identifies any deficiencies in Commission operations, programs, activities, or functions and makes recommendations for improvements in existing controls and procedures.

The Office's investigations unit responds to allegations of violations of statutes, rules and regulations, and other misconduct by Commission staff and contractors. We carefully review and analyze the complaints we receive and, if warranted, conduct a preliminary inquiry or full investigation into a matter. The misconduct investigated ranges from fraud and other types of criminal conduct to violations of Commission rules and policies and the Government-wide conduct standards. The investigations unit conducts thorough and independent investigations into allegations received in accordance with the applicable Quality Standards for Investigations. Where allegations of criminal conduct are involved, we notify and work with the Department of Justice and the Federal Bureau of Investigation as appropriate.

Audit Reports

My philosophy as an Inspector General is to focus on the significant issues and high risk areas, i.e, looking at "big picture" items, relating to whether the programs and operations in the Agency are working effectively, rather than simply identifying isolated minor infractions or procedural violations. I believe that this approach is particularly important in light of the significant challenges facing the SEC and the other government

agencies that regulate our financial markets. In this time of financial crisis, it is my view that as the agency charged with being the investor's advocate and protecting the integrity of our capital markets, the SEC must engage in critical self-analysis and address a number of difficult and complex issues. Current market conditions have created many new and unexpected challenges that need to be addressed and examined expeditiously. Therefore, it is more important than ever that financial regulatory agencies such as the SEC have an independent, effective and fully-funded Office of Inspector General to assist the Commission in confronting these challenges.

I am proud to report that over the past 14 months that I have served as the SEC's Inspector General, our Office has risen to these challenges and then some. Notwithstanding a small staff, over this short period of time, we have issued numerous detailed audit and investigative reports discussing issues critical to SEC operations and the investing public and making significant recommendations for improvement. Many of these reports have been critical of SEC operations, programs and management, and I have not always been the most popular individual at my agency. Nonetheless, I feel it is my duty to the Commission, the Congress and the investing public, particularly in these challenging times, to conduct independent audits and investigations and to issue thoughtful, unbiased and frank reports. Thus, whenever we find that criticism of the SEC is warranted and supported by the facts, we do not hesitate to report the facts and conclusions as we find them.

I will provide you with just a few examples of recent activities undertaken by my Office, some at the request of Congressional Committees. In September 2008, our audit unit issued a comprehensive report analyzing the Commission's oversight of the SEC's

Consolidated Supervised Entity (CSE) program, which included Bear Stearns, Goldman Sachs, Morgan Stanley, Merrill Lynch and Lehman Brothers. In order to give enhanced credibility to our findings, we retained the services of a recognized expert on capital markets, and market microstructure in particular. Our report provided a detailed examination of the adequacy of the Commission's monitoring of Bear Stearns, including the factors that led to its collapse. The audit identified deficiencies in the CSE program that warranted improvement and provided 26 recommendations that, if implemented, would have significantly improved the Commission's oversight of the CSE firms. In response to the report's findings, former SEC Chairman Christopher Cox announced the end of the CSE program and promised to review and move to aggressively implement the report's recommendations.

The Office of Inspector General's audit unit also issued a second report during the same time period, analyzing the Commission's Broker-Dealer Risk Assessment program. This program operates pursuant to SEC rules requiring broker-dealers that are part of a holding company structure with at least \$20 million in capital to register with the Commission, and provide information on the broker-dealer, the holding company, and other entities within the holding company system. The audit found that the SEC was not fulfilling all of its obligations in connection with the Broker-Dealer Risk Assessment Program and made several recommendations to improve the program.

Just recently, my Office has issued several other significant audit reports. In February, we issued an audit report that analyzed the \$178 million in disgorgement waivers that the Division of Enforcement (Enforcement) granted between October 2005 and May 2008. These waivers of disgorgements required to be paid by individuals or

entities that violate the Federal securities laws were granted based upon an assertion by a defendant of an inability to pay. We found that proper procedures were not always followed in recommending waivers, and the SEC did not always ensure there was appropriate documentation to confirm representations made by defendants concerning their financial condition. We provided several recommendations designed to improve the process.

Just last week, we issued a comprehensive audit report on Enforcement's practices and procedures for responding to and processing naked short selling complaints. Our report concluded that Enforcement's existing complaint receipt and processing procedures hinder its ability to respond effectively to naked short selling complaints and referrals, and Enforcement's procedures result in naked short selling complaints being treated differently than other types of complaints received by Enforcement. We also analyzed in a broader sense Enforcement's complaints, tips and referral process and provided numerous recommendations to improve the manner in which Enforcement receives and processes complaints.

We are also currently working on several additional audit reports that we plan to issue in the upcoming months that address issues currently of concern to the Commission and the investing public, including a comprehensive analysis of the SEC's oversight of the Nationally Recognized Statistical Rating Organizations. These rating organizations, also referred to as credit rating agencies, may have played a critical role in the current economic crisis and some of the financial frauds in the earlier part of this decade. We intend to identify processes that will aid with the Commission's oversight of these credit reporting agencies.

Investigative Reports

We also have a vibrant and vigorous investigative unit that under my direction is conducting, or has completed, over 50 comprehensive investigations of allegations of violations of statutes, rules and regulations, and other misconduct by Commission staff members and contractors. Several of these investigations involved senior-level Commission staff and represent matters of great concern to the Commission, Congressional officials and the general public. Where appropriate, we have reported evidence of improper conduct and made recommendations for disciplinary actions, including removals from the Federal service. Specifically, over the past year, we have issued investigative reports regarding a myriad of allegations, including claims of improper preferential treatment given to prominent persons, retaliatory termination, Enforcement's failure to vigorously pursue an Enforcement investigation, conflict of interest and solicitation of favors from an outside contractor, perjury by supervisory Commission attorneys, misrepresentation of professional credentials, falsification of personnel forms, and the misuse of official position and government resources. These investigative reports have been issued without management influence or pressure, and have focused on all level of employees and contractors, including senior SEC staff. Where appropriate, we have also referred our investigative findings to the Department of Justice for possible criminal prosecution. We are continuing to follow up with the Department and the Federal Bureau of Investigation on several ongoing criminal matters.

Bernard Madoff Investigation

In addition to the work I just described, we are conducting a comprehensive investigation and evaluation of matters related to Bernard Madoff and affiliated entities.

On the late evening of December 16, 2008, former SEC Chairman Christopher Cox contacted me and asked my Office to undertake an investigation into complaints received by the SEC regarding Mr. Madoff, going back ten years, and the reasons why the agency found these complaints lacked credibility. The Chairman also asked that we inquire into the SEC's internal policies that govern when allegations of fraudulent activity should be brought to the Commission's attention, whether those policies were followed in the Madoff matter, and whether improvements to those policies are necessary. In addition, Chairman Cox requested that the investigation include a review of all SEC staff contact and relationships with the Madoff family and firm, and any impact such relationships had on staff decisions regarding the firm.

Early on December 17, 2008, we opened an official investigation into the Madoff matter. Since that time, we have been working at a rapid pace to perform this important work and have made substantial progress to date.

Based upon the work conducted to date, we have determined that the matters that must be analyzed regarding the SEC and Bernard Madoff go well beyond the specific issues that former Chairman Cox asked us to investigate. Therefore, in addition to conducting a thorough and comprehensive investigation of issues raised by former Chairman Cox, our oversight efforts will include an evaluation of broader issues regarding the overall operations of Enforcement and the Office of Compliance, Inspections and Evaluations as they relate to the specific questions we are examining. As a result of those efforts, we intend to provide overarching and comprehensive recommendations to ensure that the Commission fulfills its mission of protecting

investors, facilitating capital formation and maintaining fair, orderly and efficient markets.

At the conclusion of our investigative efforts related to the Madoff matter, in addition to recommending disciplinary action for specific individuals as may be appropriate, we plan to provide concrete and specific recommendations to ensure the SEC has sufficient systems and resources to enable it to respond quickly and effectively to complaints and detect fraud through its examinations and inspections.

Coordinated Efforts Among Financial Regulatory IGs

In addition to the work conducted by the Office of Inspector General at the SEC, in order to strengthen the oversight of the Federal financial regulatory structure as a whole, we work in tandem with other Federal financial regulatory Inspectors General to provide coordinated oversight. For example, I currently serve on the Troubled Asset Relief Program (TARP) Inspector General Council, along with the Special Inspector General for the TARP, Neil Barofsky, and Inspectors General from the Department of Treasury, Federal Deposit Insurance Corporation (FDIC), Federal Reserve Board, the Department of Housing and Urban Development, the Federal Housing Finance Agency, the Small Business Administration, and representatives of the GAO. We meet on a monthly basis to discuss coordination of TARP-related activities and oversight efforts.

I also meet every month with the Inspectors General for the Department of Treasury, FDIC, Federal Reserve Board, the Pension Benefit Guaranty Corporation, the Federal Housing Finance Board, the Commodity Futures Trading Corporation, and the National Credit Union Administration to discuss coordinated oversight efforts among the financial regulatory IGs. I believe that these coordinated efforts are crucial to ensure a

united and common approach to the oversight of the Federal financial regulators during this time of economic crisis.

Congressional Efforts to Assist Inspectors General

I greatly appreciate the Subcommittee's interest in assisting the Inspectors General in performing their critical work and the willingness in particular to assist the efforts of my Office. With increasing pressure on the Federal financial regulators, having sufficient funds and resources to conduct oversight, as well as the requisite degree of independence, is more vital than ever.

The recently-enacted amendments to the Inspector General Act made great strides in enhancing Inspector General independence and ensuring that the Inspectors General receive sufficient appropriated funds to achieve their mission. In particular, Section 8 of the Inspector General Reform Act requires agencies to include in their budget submissions to the Office of Management and Budget (OMB) a specific breakout for Inspector General funding, as well as any comments of the affected Inspector General with respect to the proposal. Furthermore, OMB must include in the President's budget, among other things, the amount of funding requested by the President for each IG and any comments by an Inspector General who determines that the budget submitted by the President would substantially inhibit the performance of the Inspector General's mission. Other significant improvements to enhance Inspector General independence made by the Inspector General Reform Act include Section 3's requirement of 30 days advance notice to Congress of the removal or transfer of an Inspector General, as well as the provisions prohibiting cash awards or bonuses to Inspectors General and establishing the pay of both Presidentially-appointed and Designated Federal Entity (DFE) Inspectors General.

Since I began my tenure as Inspector General of the SEC in December 2007, my Office's staffing levels have increased by nearly 80%, and I have requested an increase of our overall budget of nearly 30% for Fiscal Year 2009, which I understand will be processed as soon as the funds are available. Notwithstanding these increases, additional resources would greatly assist my Office in continuing its important work. I specifically suggest that to the extent Congress provides additional appropriations to agencies such as the SEC for increased enforcement efforts, there be a commensurate and proportionate funding to the corresponding Offices of Inspectors General to provide for oversight of the additional funds allotted to the agency. There may also be other mechanisms pursuant to which appropriated funds may be directed specifically to an Office of Inspector General for oversight efforts.

Additionally, the legislation recently passed by the Senate to provide the Special Inspector General for the Troubled Asset Relief Program (SIGTARP) with additional authorities and responsibilities is illustrative of other types of measures that may be enacted to enhance Inspector General independence and effectiveness. For example, the SIGTARP legislation requires the Secretary of the Treasury to take action to address deficiencies identified by a report or investigation of the SIGTARP, or to certify to the appropriate Committees of Congress that no action is necessary or appropriate. That legislation also provides the SIGTARP with enhanced audit, investigation and personnel authorities.

Finally, I respectfully offer my opinion that converting Inspectors General from DFE Inspectors General to Presidentially-appointed Inspectors General is not necessary and, in my view, would not improve the current level of DFE Inspector General

oversight. Having been an Inspector General at two DFEs, at the Peace Corps and now at the SEC, I can state without any hesitation, that one can be a completely independent and effective Inspector General within the DFE structure. Although I have issued numerous reports at both agencies that have been critical of those agencies' operations and management and often controversial, no one has ever attempted to impair, or question, my independence. I believe that DFE Inspectors General are able to fulfill their duties to provide meaningful and independent oversight free from any outside influences, including political ones.

In my personal situation, my Office's reports and approach to oversight have not diminished in any way with the recent change in administration and appointment of a new SEC Chairman. I can report that politics play absolutely no role in my Office's decisions and, as a DFE Inspector General, I am completely unaffected by political considerations or processes. For this reason, I do have some concerns that converting the Inspector General of the SEC, or the Inspectors General of other financial regulatory agencies, from DFE to Presidentially-appointed Inspectors Generals could result in an unnecessary "politicization" of the Office of Inspector General. There are additional potential drawbacks to the Presidentially-appointed Inspector General process, including the often lengthy vetting and confirmation process that may lead to the Inspector General position being vacant for a significant period of time. During this time of financial crisis, it is more important than ever that there is continuity of the operations and oversight activities currently undertaken by Inspectors General of financial regulatory agencies.

Concluding Remarks

In conclusion, I greatly appreciate the Subcommittee's interest in the SEC and my Office. I believe that the Subcommittee's and Congress's involvement with the SEC is extremely important to strengthen the accountability and effectiveness of the Commission. I also believe very strongly that a dynamic and effective Office of Inspector General is critical to achieving the mission of all Federal agencies, including the SEC. I take very seriously my Office's responsibility to detect and report waste, fraud and abuse, as well as the concern and interest of this Subcommittee in the efficiency and effectiveness of my Office and the SEC. Thank you.

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